

Reserve
HJ2449
C42

Charities and the Canadian Tax System

A Discussion Paper

May 1983

Canada



HJ2449
C42

Charities and the Canadian Tax System

A Discussion Paper

DATE DUE

May 1983

FINANCE - TREASURY BOARD
LIBRARY - REC'D.

AUG 16 1983

FINANCES CONSEIL DU TRÉSOR
BIBLIOTHÈQUE - REÇU



Department of Finance
Canada

Ministère des Finances
Canada

10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50
51
52
53
54
55
56
57
58
59
60
61
62
63
64
65
66
67
68
69
70
71
72
73
74
75
76
77
78
79
80
81
82
83
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
100

Preface

Publication of this paper continues an extended process of consultation towards the goal of improving the tax rules under which Canada's charitable organizations and foundations operate.

The proposals which follow seek to promote the long-standing public policy of providing a tax environment in which charities can thrive and make their valued and essential contribution to the health and well-being of our Canadian society. The proposals seek, at the same time, to meet the public interest of ensuring that the charitable donations and investments being encouraged through substantial tax benefits are disbursed, in fact, for charitable purposes.

Proposals towards this end were presented in the budget of November 12, 1981 and later in a press release of April 21, 1982 and in the Economic Statement of October 27, 1982. These proposals have been the subject of extensive consultations with representatives of various charities. We acknowledge with thanks their valuable contribution towards strengthening and improving the tax framework in which Canadian charities work.

This consultative document, including draft legislation, is being issued now to elicit further comments for its improvement. Recognizing the wide diversity of charitable organizations and the variety of their individual interests, we invite comments from charities, whether individually or collectively, through their representative organizations.

These comments should be made by August 15, 1983 and should be addressed to the Tax Policy and Legislation Branch, Department of Finance, 160 Elgin Street, Ottawa, Ontario, K1A 0G5.

Table of Contents

Chapter 1.....	1
Chapter 2.....	7
Appendix	15
Legislation and Regulation	23
Explanatory Notes.....	37

Chapter I

Introduction

Organized charity has long played a significant role in the development of Canadian society. Throughout the years, numerous foundations and charitable organizations have benefitted Canadians and people of other countries by assisting the poor, encouraging education, funding scientific and medical research, furthering religious study and awareness, supporting cultural activities and contributing to the general development of our communities.

The Government of Canada has long been committed to encouraging charities in this role, providing them with an environment in which they can grow and flourish.

Charities and the Income Tax Act

The principal vehicle for government encouragement of charity in Canada has been the Income Tax Act. While organized charity long pre-dates income tax, two significant tax advantages allowed to charities are of crucial importance to their funding and functioning. The key to these tax advantages is registration under the Income Tax Act.

Once registered with the Minister of National Revenue, a charity is exempt from tax on any income earned by it. This tax concession has had significant results. It is estimated that, today, charitable foundations in Canada hold well over \$10 billion in property.

Second, registered charities have the right to receive donations that are tax-deductible to the donor. In 1980, charitable gifts in this country totalled more than \$2 billion. The deductibility of charitable gifts is obviously an inducement to giving. The deduction is estimated to reduce federal and provincial tax revenues by some \$600 million annually.

Recognition of charitable giving in the calculation of taxable income is found in the very first income tax legislation introduced in Canada in 1917. Over the years, however, there has been concern that some organizations receiving charitable gifts may not in fact be devoting enough of them to charitable purposes. Accordingly, in 1950, a number of rules for charitable trusts and corporations were introduced into the Income Tax Act.

A second revision occurred in 1966. To ensure verifiable receipts, charities were required to register with the Minister of National Revenue and to file information returns on their activities.

The latest revision occurred in 1976 when the tax law affecting charities underwent a major overhaul. The revised legislation provided disbursement tests for charities, that is, it required charities to spend certain minimum amounts on charitable activities. It also introduced the concept of qualified investments and required the filing of public information returns. The old distinctions between charitable trusts, organizations and corporations were dropped and new classes of charities were introduced: private foundations, public foundations and charitable organizations. In very general terms, foundations expend funds by donating to other charities while organizations are involved directly in charitable activities.

The 1976 amendments also introduced a number of changes which facilitated the activities of registered Canadian charities. Provision was made to allow charities to meet disbursement quotas while accumulating resources for the funding of specific approved projects. In addition, inter-charity transfers of both income and capital were permitted.

In order to maintain their special status, charities are required to disburse certain minimum amounts of their funds or assets on charitable activities. For foundations, this disbursement requirement is currently set at 90 per cent of income. For charitable organizations the test is 80 per cent of receipted gifts.

From the standpoint of charities, certain difficulties arise from the existing provisions relating to the disbursement rules.

- (1) The rule requiring organizations to expend 80 per cent of gifts on charitable activities limits an organization's ability to accept endowments the terms of which require it to retain the capital and spend only the resulting income.
- (2) The rule requiring foundations to expend 90 per cent of their income has made it difficult in an inflationary environment for them to invest in income-producing assets while protecting the real value of their investments. In the recent period of high interest rates, the rules forced many foundations to make disbursements at a rate that seriously eroded the real value of their assets.

From the standpoint of public policy, the disbursement rules suffer from other defects as well.

- (1) The existing rules allow the disbursement requirements to be satisfied by transferring funds between charities without any of the funds necessarily being devoted to charitable activities.
- (2) The fact that the disbursement obligations differ as between charitable organizations and charitable foundations enables charities to minimize their disbursement requirements by changing their status. A charity may minimize its expenditures on charitable activities by qualifying as a foundation in years when it has little income and as an organization in years when it receives few gifts.
- (3) The existing income disbursement rule for foundations does not deal effectively with investments in assets held for growth rather than income. Capital gains are excluded from a charity's income. Thus, to the extent that a foun-

ation arranges its investments to realize the return on its investments as capital gains rather than as interest or dividends, it is not required to expend its earnings on charitable activities.

The provisions relating to qualified investments give rise to a major area of concern where a charity invests in a company and both are controlled by the same person or group of persons. This concern has been heightened by a recent court decision involving a company and its employees who made donations to a foundation controlled by the shareholders. The employees' donations were made out of special bonuses that were paid to them. In turn, the foundation made low-interest loans to the company in the amount of the donations received. As a result of this decision, it is open to the shareholders of a company to establish a foundation, to obtain a deduction for funds contributed, directly or indirectly, to the foundation, and continue to use the funds in the business while little, if any, of the resources of the foundation are devoted to its charitable purposes.

Proposals

The proposals in this paper seek to address the difficulties outlined above and, at the same time, to simplify the system. Despite the broad sweep of the changes proposed, it is expected that for the vast majority of the more than 46,000 registered charities in Canada, these changes would have little or no effect. The main thrusts of these proposals are summarized below.

(1) The legislative distinction between charitable foundations, both public and private, and charitable organizations would be eliminated.

The primary importance of this distinction under the existing Act has been in the rules relating to minimum disbursements for charitable activities. The removal of the distinction and the application of the same disbursement requirements to all charities would allow for a significant simplification of the law. It would also allow charities the flexibility to change their methods of operation to suit changing circumstances without being confined by the existing concepts of foundations and organizations.

(2) The concept of related charities would be introduced.

The concept of related charities is necessary to ensure that the new rules relating to disbursements are effective and cannot be circumvented by arranging for gifts between charities where they are not operating at arm's length or where they are acting in concert. Under the new rules, where a charity has received a gift from a related charity, it would be required to expend the full amount on charitable activities in the year of receipt. Further, for the purposes of the disbursement requirements, gifts in a year by a charity to related charities would be counted under the disbursement rules only to the extent that the gifts exceed the total of all gifts it received from related charities in the same year. This netting of gifts between related charities means that gifts made to related charities would be recognized as disbursements on charitable activities only to the extent that they exceed the total of all gifts received from related charities.

(3) The calculation of disbursement quotas for charities would be significantly altered.

Under the existing Act, foundations are required to disburse 90 per cent of their income (which includes gifts received) and charitable organizations are required to disburse 80 per cent of all receipted gifts. As a result of discussions with numerous foundations, the income test has been removed. The general test for all charities would require them to disburse a minimum amount based on both gifts received and invested capital. The minimum proposed is 80 per cent of all gifts received (with certain exceptions such as gifts between related charities, endowments and gifts out of the capital of a donor charity) and 4.5 per cent of the value of its investments. The latter test, based on invested capital, would provide a fairer disbursement requirement than the test related to income of foundations in that it would no longer vary depending on whether the return on investments is in the form of income or capital gains. It would also make it easier for most foundations to protect the real value of their investments in an inflationary period.

(4) Charities which fail to meet their disbursement obligations would be subjected to tax on the shortfall.

In the existing Act, the sanction available where a charity has failed to meet its disbursement quota is deregistration. In the majority of cases this sanction is excessive. In place of this threat of deregistration, a special tax would be imposed on any deficiency in meeting a charity's disbursement quota. This special tax would consist of two parts: an initial tax of 15 per cent of the disbursement shortfall and a 100 per cent tax if, after the charity has been formally notified, it failed to make up the deficiency.

(5) The concept of non-qualified investments would be introduced and applied to all charities.

This proposal would eliminate the concept of qualified investments, which applied only to private foundations, and replace it with rules relating to non-qualified investments which would apply to all charities. A non-qualified investment would include any non-arm's length investment by a charity where there is a potential for self-dealing between the charity and related persons.

(6) A person who derives a benefit from a non-qualified investment of a charity would be required to include twice the amount of the benefit in his income subject to tax.

This rule is intended to prevent persons who are in a non-arm's length relationship with a charity from using the charity to obtain a financial benefit. To determine whether such a benefit occurs, the following guideline would apply: non-qualified investments of a charity would be required to earn a return equal, in the case of debt, to the prescribed interest rate and, in the case of shares, to two-thirds of the prescribed interest rate. The prescribed interest rate is the interest rate charged on overdue tax payments and paid in respect of tax refunds. Persons who have benefitted from non-qualifying investments that yield less to a charity than the guideline return would be required to include in income twice the amount by which the guideline return exceeds the actual return. For taxpayers at the 50-per-cent tax rate, this would effectively eliminate the benefit. Transitional rules have been provided for non-qualifying investments made before April 22, 1982.

Conclusion

Canadians interested in charitable activity in this country are encouraged to review these proposals and provide comments for change or improvement in light of the objectives they are designed to achieve. To allow for considered comment and review, this paper contains the proposed legislation and regulations together with commentary on the operation of each provision.

22

23

24

25

26

27

28

29

30

31

32

33

34

35

36

37

38

39

40

Chapter 2

In this chapter, some of the changed or new concepts which are essential to the functioning of the proposed system are explained. These concepts are:

- A. disbursement quota
- B. qualified disbursements
- C. major donors
- D. non-qualified investments
- E. related charities

The disbursement quota and qualified disbursements concepts would affect all charities. The latter three would affect few of the many thousands of Canadian charities.

A. Disbursement Quota

The disbursement quota determines the minimum amount that a registered charity is required to spend during a year either on its own charitable activities or as gifts to other charities. The concept of disbursement quota was introduced in 1976. However, different disbursement requirements applied to the different categories of charities. A single disbursement quota is now proposed for all charities. While the new disbursement quota retains elements of the existing requirements, it is modified to reflect two major proposals. The first, contained in the budget of November 12, 1981, bases the quota on all gifts received, not just those for which a tax receipt was issued. The second is the change, announced in the news release of April 21, 1982, that the quota for foundations, in respect of their investment income, would be based on a percentage of invested capital rather than a percentage of investment income. Additional modifications are included to accommodate special circumstances not now dealt with.

The proposed disbursement quota rule consists of six elements. Most charities will be concerned with only one or two of these elements; the others deal with special situations which do not affect the vast majority of charities, such as gifting among charities that are related to each other. The six elements of the disbursement quota are:

- gifts from related charities in the current year,
- loans,
- gifts received in the previous year,
- term gifts,
- transitional provision for existing foundations, and
- investments.

The majority of charities would have to disburse in a year only 80 per cent of gifts received in the previous year, while many charities which are currently foundations would be subject only to the requirement to disburse 4.5 per cent of the value of their investments.

Gifts from Related Charities

A charity would be required each year to disburse 100 per cent of gifts received in the year from a related charity. This provision will affect only those gifts between charities which are related to each other. Where this occurs the recipient charity generally would be required to disburse, outside the group of related charities, an amount equal to the total of all gifts it receives from charities related to it. However, certain gifts from related charities are excluded from this requirement:

- a gift received out of the capital of a related charity, and
- a gift of tangible capital property from a related charity to the extent that it is used in charitable activities or administration of the recipient or some other charity.

If a gift of tangible capital property ceased to be used for charitable or administrative purposes, the value of the property at that time would have to be included in the disbursement quota of the recipient for the following year.

Loans

A charity would be required to include in its disbursement quota for a year all amounts it has borrowed in the year and all amounts received in the year as a repayment of loans it has made previously. This applies to those borrowings or loans that have been made in connection with its charitable activities or administration.

Loans are not dealt with under the existing disbursement requirements. The purpose of the new rules is explained in the following examples.

The first example is that of a charity formed to construct a local hospital. It has received donations but also has taken out a mortgage in order to erect the facility. Without the new provision, the payment for the building is a qualified disbursement which exceeds the disbursement quota by the amount of the mortgage; in following years the charity will seek further gifts in order to make payments on the mortgage and such mortgage payments will not constitute charitable outlays. The mortgage payments will not be qualified disbursements and the charity can thereby fail to meet its disbursement quota. To correct this inappropriate result, the new rules recognize the mortgage repayments as qualified disbursements. In addition, in order to prevent the charity from obtaining a double disbursement for the same undertaking – once when the mortgage proceeds are spent on the facility and again as the mortgage is paid off – the mortgage proceeds would be included in the disbursement quota. The initial disbursement on the facility offsets this inclusion and the subsequent payments in reduction of the mortgage would be applied against its disbursement quota for the year of payment.

The second example assumes that a charity carries out its charitable purposes by making low-interest or interest-free loans. Again, without specific provisions, such outlays do not count as qualified disbursements that go towards meeting the charity's disbursement quota. However, the proposed definitions would include such loans as qualified disbursements. Hence, if and when a repayment is received on such a loan, it must be added to the disbursement quota and either lent again or spent on some other qualified disbursement.

In the course of discussions with representatives of various charities and their associations, some concern was expressed about the situation where a charity receives a gift of property from a related charity, such as a building, which it uses in its activities. When the building is received, its value is specifically excluded from the charity's disbursement quota. If several years later the charity decides that it does not need the building and sells it, it will be required to bring the fair market value of the building into its disbursement quota for the year following the sale. If the sale is for cash, there will be funds available to spend on charitable works, but if a mortgage is taken back, that portion of the funds will not be available for disbursement. Under the proposed rules, the giving of the mortgage would represent a qualified disbursement, and receipts on the mortgage would be included in the disbursement quota. In this way, the value of the building would not have to be disbursed until it is actually received. Although this will be a rare occurrence, serious cash flow problems could arise without this provision.

Gifts Received in the Previous Year

A charity would be required to disburse in a year 80 per cent of gifts received in the preceding year. This is largely a continuation of the existing requirement for charitable organizations. It is proposed, however, to apply this requirement to all gifts received, with some exceptions, rather than only to gifts for which a receipt for tax purposes was issued.

Among the exceptions are gifts received out of the capital of another charity and gifts of tangible property to the extent that they are used in the charitable activities or administration of the recipient or some other charity. These parallel the exclusions described above under the rules relating to gifts from related charities. However, in this case, where a gift of tangible property ceased to be used in such activities or administration its value would not be added to the disbursement quota. Rather, it would be added to the pool of investments that are subject to the 4.5-per-cent test described below. In addition, gifts from related charities are excluded from this computation since they are dealt with separately under the rules described above.

Three other exclusions are for testamentary gifts or gifts to which the donor has attached special conditions. One of these exclusions is gifts, often referred to as endowments, where the donor has specified that the principal is to be held by the charity for at least 10 years. At present, only foundations are able to exclude such gifts in determining their disbursement quota. Under these proposals, all charities would be able to exclude them. The present rules often effectively bar charitable organizations from accepting such gifts. Under the existing rules, if a donor wants a receipt for tax purposes, the charity is required to expend 80 per cent of the gift in the year following its receipt. This conflicts with the terms of the gift which require that it be held and not spent.

The second exclusion is for a gift which the donor has specified is to be used over a term of years, less than 10, rather than being used in one year. For example, a contributor might donate \$50,000 and specify that it is to be used for a particular purpose over the next four years. Such a gift would be excluded from the rule that requires an outlay of 80 per cent of the gift in one year. However, it would be dealt with in the rule described below which requires 80 per cent of the annual portion of the gift to be included in the disbursement quotas for the number of years specified by the donor.

The third exclusion is for a testamentary gift where the testator has not specified whether the gift is to be treated as an endowment or spent currently. The charity would be able to treat such a gift as an endowment thereby excluding it from the 80-per-cent disbursement requirement. Testamentary gifts of this nature have created problems for some churches and community foundations and this provision should resolve these problems.

Gifts to be Used Over a Period of Less Than 10 Years

This section brings into the disbursement quota 80 per cent of the portion of a gift to be spent in a year where the donor has specified that the gift is to be spent over a specified number of years.

Transitional Provision for Foundations

A special transitional rule is proposed for those charities that are currently charitable foundations and that claim a reserve under subsection 149.1(18) of the Income Tax Act in the last year under the existing provisions. Those charities would be required to bring this reserve into their disbursement quotas over a period of not more than 10 years to the extent that it is not otherwise brought into the disbursement quota.

4.5-per-cent Rule for Investments

This rule would apply to all charities which now qualify as foundations and to other charities with substantial investments. It would not apply to a charity which has investments of less than \$250,000 and which in the previous year did not give more than 25 per cent of its charitable outlays to other charities. This exclusion would remove most organizations from this requirement.

Charities would be required to include in their disbursement quota 4.5 per cent of the value of their investment properties owned at the beginning of any year. For most investments, this value will be the fair market value. However, non-qualified investments cannot be valued at an amount less than their cost to the charity. In order to even out random fluctuations in market value, these values may be determined by reference to their average value over a two-year period. This averaging valuation method also incorporates a technique which allows a charity time to build up to the full disbursement outlay when new endowments are received. The valuation method is described in the explanatory notes on subsection 188(2).

B. Qualified Disbursements

The qualified disbursements that count towards meeting a charity's disbursement quota are defined as outlays made by the charity in carrying on its own charitable activities and include overhead and administrative outlays related to such activities. However, outlays made in connection with fund-raising, investments, and general administrative expenses not directly related to its charitable activities are not considered as qualified disbursements. A gift by a charity to another charity or to an organization to which contributions are deductible for tax purposes is also a qualified disbursement. These aspects are unchanged from the present legislation.

As discussed in the commentary on the disbursement quota, qualified disbursements would also include the amount of funds loaned by a charity as part of its charitable activities or administration as well as any repayments it makes on funds it has borrowed.

Special rules would apply to gifts between related charities. These rules seek to ensure that the objective of the disbursement requirements – namely that funds be expended annually on charitable activities – is achieved. In the absence of special rules it would be possible for a group of related charities, by making gifts between themselves, to avoid expending any funds on charitable activities. Gifts by a charity to a related charity would constitute qualified disbursements only to the extent that the total of gifts made to related charities exceeds the total of gifts received from related charities.

In addition to actual expenditures, funds accumulated in a year for a purpose approved by the Minister of National Revenue would also constitute qualified disbursements.

C. Major Donor

Major donor is a newly defined term, although elements of the concept have existed in connection with private foundations. This concept is basic to the definitions of non-qualified investments and related charities.

As the words imply, a major donor is a person or family which has contributed a significant portion of the funds made available to a charity. The provision would apply most often to those charities which under the existing law qualify as foundations. It also could apply to a charitable organization, particularly those created by foundations to carry on their charitable activities.

A major donor includes a charity, person or a group of related persons who have contributed more than 10 per cent of all gifts received by the charity after January 1, 1983. Major donors would also include those persons or groups of related persons whose contributions to a charity caused it to qualify as a private foundation in the year before these proposed provisions come into effect. Persons related to a major donor also are classed as major donors.

In the course of our discussions with representatives of charitable foundations, they expressed concern over how this rule would apply to those foundations which have a

practice of providing "seed" funds in order to get a new charity or a new program established. There was concern that the donor charity might be classified as a major donor and, thereby, related to the other even though its seed fund contribution was insignificant in terms of its overall activities. Consequently, an exclusion has been provided so that gifts which are not significant in the donor's overall activities would not cause it to be a major donor of the other charity, even though the gift may be significant to the recipient charity. In addition, a further relieving provision would allow the Minister of National Revenue to declare charities not to be related for such years as he specifies. This is intended to apply where the Minister is satisfied that the major donor status arises solely in the course of establishing the new charity or new program.

For the purpose of identifying major donors, the amount of gifts made to a charity includes the amount by which the fair market value of property transferred to the charity exceeds the amount paid for it by the charity, as well as the amount of any outstanding loan to the charity by a potential major donor who is not in the business of lending money. Frequently, charitable gifts are made by will. The charity may not receive the gift or even know its amount until many years after the donor's death. To cope with this problem, the amount of such gifts would not be included in the determination of the donor's status until the charity receives it, although the composition of the related group to which the testator belonged would be required to be determined immediately before his death.

D. Non-Qualified Investments

The existing concept of qualified investments, which applies only to private foundations, would be replaced by the concept of non-qualified investments which would apply to all charities. A non-qualified investment of a charity could be either a debt obligation or share investment where the debtor or issuing corporation does not deal at arm's length with the charity.

Debt obligations owing to a charity would be non-qualified investments where the debtor is:

- (1) a major donor or officer of a charity, or another person who is in a position to influence the actions or decisions of the charity,
- (2) a person who does not deal at arm's length with a person referred to in (1),
- (3) a corporation which the charity controls, or which is controlled by persons referred to in (1) or (2), whether individually or in combination, or
- (4) a related charity that is not a registered charity.

Shares owned by a charity would be non-qualified investments where they are issued by a corporation referred to in (3) above, that is, a corporation whose debt would be a non-qualified investment for a charity.

There are, however, a number of significant exclusions in the definition of non-qualified investments. The following investments would be excluded:

- a debt which is a pledge or undertaking to make a gift to a charity,

- shares of a corporation listed on a prescribed stock exchange in Canada, and
- any debt owing by, or shares of, a limited dividend housing corporation or a corporation controlled by the charity that limits its operations to holding property used by the charity.

Where the non-qualified investment does not produce a prescribed rate of return a penalty would be imposed on the debtor or issuing corporation. This penalty would be in the form of an income inclusion representing twice the difference between the return calculated at the prescribed rate and the actual return to the charity. This penalty is designed to ensure that a non-arm's length debtor does not benefit from terms and conditions which are less favourable to the charity than those which would exist in an arm's length arrangement.

There is a transitional provision which gradually phases in the required rate of return on those non-qualified investments acquired by the charity before April 22, 1982. The calculation of the required rate of return and the transitional provision are set out in subsections 149.1(15) to (18) in the draft legislation attached.

E. Related Charities

Under the existing rules related to disbursements, it is possible for a group of charities to effectively reduce or dilute their disbursement requirements by making gifts amongst themselves. Suppose, for example, that a charity makes a gift of \$100 to another charity. The donor charity is considered to have spent \$100 on charitable activities. The recipient, in turn, is required to expend \$80 (80 per cent of \$100) on charitable activities. If it does so by making a gift of \$80 to a third charity, the disbursement requirement effectively is reduced to \$64 (80 per cent of \$80). Although the first charity would be treated as having spent \$100 on charitable activities, nothing may, in fact, have been spent directly on such activities. Furthermore, the disbursement requirement, now reduced to \$64, would be deferred for two years.

This dilution and postponement of the amount required to be expended on charitable works is difficult to justify in those circumstances where there is a connection between the charities involved. The concept of related charities, first proposed in the budget of November 12, 1981, is introduced to prevent this dilution and postponement of the disbursement requirements. It is proposed that gifts received from a related charity be required to be fully spent on charitable activities in the year in which they are received.

This treatment of gifts among related charities is effective where all the charities involved have the same fiscal year-end. It would not be effective, however, where the related charities have different year-ends. In order to prevent the undue postponement and dilution of the disbursement requirement, a netting of gifts from and to related charities is necessary. It is proposed, therefore, that the qualified disbursements of a charity for any particular year be increased only by the extent to which gifts made by it to related charities exceed gifts received by it from related charities. This proposal means that a charity that has received gifts from a related charity would not meet its disbursement quota in respect of those gifts to the extent it makes

gifts back to the same charity or to another related charity. It would be required either to use the gift in its own charitable activities or make a contribution to an unrelated charity.

The related charity status is important in determining the disbursement quota of a charity. There are certain circumstances which always would give rise to this status. By definition, charities would be related where:

- they have major donors in common who together have contributed 10 per cent or more of the gifts received by each of the charities up to that time,
- they do not deal with each other at arm's length,
- one charity was created to further the purposes of the other, or
- one is a major donor of the other.

In addition, if a consistent pattern of making significant gifts exists among a group of otherwise unrelated charities, the Minister of National Revenue would have the authority to direct that those charities be treated as related if there is persistent dilution and postponement of charitable outlays. The Minister of National Revenue would be authorized to direct that charities be considered related:

- where there is a pattern of flowing significant gifts amongst a group of otherwise unrelated charities and, when these significant gifts are not taken into account, the aggregate of the qualified disbursements for the members of the group falls short of their aggregate disbursement quota, or
- where a charity satisfies more than 50 per cent of its disbursement quota by making gifts to another charity which also satisfies more than 50 per cent of its disbursement quota in the same way.

Conversely, the Minister would also be given the discretion to direct that charities which are otherwise related would not be treated as related. Where, for example, charities would be related because one controlled the other, the Minister could make such a direction if he is satisfied that, despite the element of control, the charities, in fact, do operate independently. He could also make such a direction where a charity becomes a major donor by providing seed money for a new charity. This would occur where the charity is not excluded by the seed money exception in the definition of major donor and the Minister is satisfied that the failure to qualify under the exception is only a temporary condition.

Appendix

Examples of the Calculation of the Disbursement Quota

The examples which follow illustrate the calculation of a charity's disbursement quota. They range in scope from the simple to the very complex.

Example 1

A small charitable organization has been operating for several years. It spends about two-thirds of its donations in the year of receipt and the balance in the following year. It uses only voluntary help, is not related to any other charity, and has a December 31 year-end. None of its donations is subject to any special restrictions.

	1983	1984	1985
	(dollars)		
Gifts	20,500	22,000	18,000
Cash on hand and in bank—Dec. 31	7,500	8,000	12,000
Charitable expenditures	—	21,500	14,000

Disbursement Quota – 1984

Item 1 – Related charities	Not applicable
2 – Loans and borrowings	Not applicable
3 – 80 % of 1983 gifts of 20,500	16,400
4 – 80 % of term gifts	Not applicable
5 – Foundation transitional	Not applicable
6 – 4.5 % of investments	Not applicable
	<u>16,400</u>
Quota for 1984	<u><u>7,500⁽¹⁾</u></u>

Disbursement Quota – 1985

As in 1984, only item 3 is applicable.

Item 3 – 80 % of 1984 gifts of 22,000 =	<u><u>17,600</u></u>
---	----------------------

⁽¹⁾ Because this is the first year under these new proposals there is a special provision which limits Item 3 of the disbursement quota to the amount of funds or investments on hand at the beginning of the year. In this case those funds are \$7,500—the bank balance at the end of 1983. Hence, this charity's disbursement quota for 1984 is \$7,500.

In 1984, the charity's disbursement quota was \$7,500. Since it spent \$21,500 on charitable activities, it had an excess of \$14,000 for 1984. Its 1985 disbursement quota was \$17,600 but it spent only \$14,000 leaving a deficiency of \$3,600. However, it may apply \$3,600 of the 1984 excess to this deficiency thereby fulfilling its disbursement quota. It still has an excess of \$10,400 (\$14,000 less \$3,600) which it may apply towards deficiencies in the years 1986 through 1989.

Example 2

Mr. Smith established a small charitable foundation with an endowment of \$75,000 in 1979. The charity may spend its income on gifts to operating charities. It has voluntary help only, is not related to any other charity and has a December 31 year-end. It has received no gifts since the endowment of \$75,000 and claimed a reserve of \$6,500 under subsection 149.1(18) for 1983.

	1983	1984	1985
		(dollars)	
Investment income	6,500	7,800	6,900
Value of investments on January 1	83,000	87,000	81,000
Charitable expenditures	—	5,000	4,500

Disbursement Quota – 1984

Item 1 – Related charities	Not applicable
2 – Loans and borrowings	Not applicable
3 – 80 % of 1983 gifts	Not applicable
4 – 80 % of term gifts	Not applicable
5 – Foundation transitional (an amount not less than 1/10 of 90 % of 6,500 = 585)	1,000 ⁽¹⁾
6 – 4.5 % of 87,000	<u>3,915</u>
Quota for 1984	<u><u>4,915</u></u>

Disbursement Quota – 1985

—As in 1984, items 1 to 4 are not applicable.

Item 5 – not less than 1/9 of [(90 % of 6,500) — 1,000] =	539
6 – 4.5 % of 81,000	<u>3,645</u>
Quota for 1985	<u><u>4,184</u></u>

⁽¹⁾ The foundation has the option of choosing any amount between \$585 and \$6,500.

Since the charity made charitable disbursements of \$5,000 in 1984 and \$4,500 in 1985, it has fulfilled its disbursement quota for both years. It has excesses of \$85 in 1984 and \$316 in 1985. It can apply the 1984 excess to reduce a deficiency up to the end of 1989 and the 1985 excess to reduce a deficiency up to the end of 1990.

Example 3

This is a more complicated example. This charity is large and has extensive operations. As in the other examples, it has a December 31 year-end, but in other ways it is much different. It is related to other charities, it carries on some charitable activities but mostly it makes gifts to other charities, it receives gifts for current expenditure and as endowments, and it has a substantial investment portfolio.

	1983	1984	1985
	(dollars)		
Investments at January 1 (valued in accordance with subsection 188(2) and the prescribed regulations)		8,750,000	9,200,000
Investment income	400,000	525,000	515,000
Gifts received	870,000	900,000	925,000
Reserve under 149.1(18)	1,200,000		

Analysis of Gifts From:

	Included under "other sources"		
A. Related charities	since related	35,000	5,000
Gift out of capital	concept did		
Tangible property used	not exist	12,000	3,000
in charitable activity	in 1983	<u>113,000</u>	<u>64,000</u>
Other		<u>160,000</u>	<u>72,000</u>
B. Other sources			
Gift out of capital		22,000	45,000
Tangible property used in		8,000	13,000
charitable activity			
Endowments (required to be			
held for more than 10			
years)	170,000	125,000	82,000
Gifts to be used over			
5 years		95,000	
3 years		30,000	18,000
Testamentary gifts without			
direction			60,000
Other (received donations for			
1983)	<u>700,000</u>	<u>460,000</u>	<u>635,000</u>
	<u>870,000</u>	<u>740,000</u>	<u>853,000</u>
	<u>870,000</u>	<u>900,000</u>	<u>925,000</u>

Disbursement Quota – 1984**Quota**

		(dollars)	
Item 1	Gifts from related charities in 1984	160,000	
	Less: out of capital	35,000	
	tangible property	<u>12,000</u>	
		<u>47,000</u>	113,000
Item 2	Loans		not applicable
Item 3	Gifts from others in 1983	870,000	
	Less: endowments	<u>170,000</u>	
	80 % of	700,000	560,000
Item 4	80 % of term gifts		not applicable
Item 5	Transitional re reserve not less than 1/10 of 90 % of (1,200,000 – 700,000) =		45,000
Item 6	Investments	8,750,000	
	Less: item 3	<u>560,000</u>	
	4.5 % of	8,190,000 =	<u>368,550</u>
Quota for 1984			<u><u>1,086,550</u></u>

Disbursement Quota – 1985

Item 1	Gifts from related charities in 1985	72,000	
	Less: out of capital	5,000	
	tangible property	<u>3,000</u>	
		<u>8,000</u>	64,000
Item 2	Loans		not applicable
Item 3	Gifts from others in 1984	740,000	
	Less: out of capital	22,000	
	tangible property	8,000	
	endowments	125,000	
	for use over 5 years	95,000	
	for use over 3 years	<u>30,000</u>	
	80 % of	<u>280,000</u>	
		460,000 =	368,000
Item 4	Gifts for use over 5 years		
	80 % of <u>95,000</u> =	15,200	
	5		
	Gifts for use over 3 years		
	80 % of <u>30,000</u> =	<u>8,000</u>	23,200
	3		
Item 5	Transitional re reserve not less than 1/9 of [90 % of (1,200,000 – 700,000) – 45,000] =		45,000
Item 6	Investments	9,200,000	
	less: item 3 – 368,000		
	4 – <u>23,200</u>	<u>391,200</u>	
	4.5 % of	8,808,800	=
			<u>396,396</u>
Quota for 1985			<u><u>896,596</u></u>

4

10

•

4

4

12

Legislation and Regulation

1. 2. 3. 4. 5. 6. 7. 8. 9. 10. 11. 12. 13. 14. 15. 16. 17. 18. 19. 20. 21. 22. 23. 24. 25. 26. 27. 28. 29. 30. 31. 32. 33. 34. 35. 36. 37. 38. 39. 40. 41. 42. 43. 44. 45. 46. 47. 48. 49. 50. 51. 52. 53. 54. 55. 56. 57. 58. 59. 60. 61. 62. 63. 64. 65. 66. 67. 68. 69. 70. 71. 72. 73. 74. 75. 76. 77. 78. 79. 80. 81. 82. 83. 84. 85. 86. 87. 88. 89. 90. 91. 92. 93. 94. 95. 96. 97. 98. 99. 100.

PROPOSED AMENDMENTS TO THE INCOME TAX ACT WITH RESPECT TO CHARITIES

1. (1) Subsection 56(1) of the said Act is amended by striking out the word "and" at the end of paragraph (u) thereof, by adding the word "and" at the end of paragraph (v) thereof and by adding thereto the following paragraph:

"(w) any amount deemed by subsection 149.1(15) or (17) to have been received by the taxpayer as a benefit in the year."

(2) Subsection (1) is applicable to taxation years commencing after 1983.

2. (1) Paragraph 110(8)(c) of the said Act is repealed.

(2) Subsection (1) is applicable to taxation years commencing after 1983.

3. (1) Section 149.1 of the said Act is repealed and the following substituted therefor:

"149.1 (1) In this section and Part V,

(a) "charity" means a foundation, association, trust or other organization, whether or not incorporated,

(i) constituted and operated exclusively for charitable purposes (including the disbursement of funds to a qualified donee and the carrying on of a related business) and for administrative and fund-raising activities related to such purposes, and

(ii) no part of the property of which is transferable to or otherwise available for the personal use or benefit of any person who is a member, shareholder, trustee, settlor, officer, official, director or major donor thereof or any other person who does not deal at arm's length with any such person,

and, for the purpose of this paragraph, (iii) property shall be deemed to be transferable to or otherwise available for the personal use or benefit of a person where a charity has, in any circumstances, paid to that person any amount that is in excess of the amount that would have been reasonable in the circumstances if the charity and the person had been dealing with each other at arm's length, and (iv) property shall be deemed not to be transferable to or otherwise available for the personal use or benefit of a person where a charity pays to that person any amount as a price, rental, royalty or other payment for or in respect of property or as consideration for services that is not in excess of the amount that would have been reasonable in the circumstances if the charity and the person had been dealing with each other at arm's length;

(b) "major donor" of a charity at any particular time means

(i) a person (including any other charity), who has made a specified gift to the charity or a member of a group of persons that was a related group at the time a gift was made by a member of the group to the charity if the aggregate of all specified gifts made by the person or by members of the related group, as the case may be, constitutes more than 10% of all gifts made to the charity after December 31, 1982 and before the particular time,

(ii) in the case of a charity that was, in its last taxation year commencing before 1984, a private foundation (within the meaning assigned by paragraph 149.1(1)(f) as it then read), a person or each member of a group of persons that was a related group at the time a contribution was made to the charity, whose contributions to the capital of the charity disqualified it as a public foundation

Benefit

Definitions

"charity"

(within the meaning assigned by paragraph 149.1(1)(g) as it then read), except where their contributions to the capital of the charity equaled at the particular time in aggregate less than 10% of the capital contributed to the charity as of that time,

(iii) any person who was at that particular time related to a major donor of the charity, and

(iv) a major donor of any other charity that is a major donor of the charity,

and, for the purpose of this paragraph,

(v) in determining the amount of gifts made to a charity by a person there shall be included the aggregate of

(A) the amount, if any, by which the fair market value of property transferred by that person to the charity at the time of transfer exceeds the fair market value at that time of the consideration received therefor, and

(B) the outstanding balance at the particular time of any loan (other than a loan made in the ordinary course of business by such person part of whose ordinary business was the lending of money) made by such person to the charity, and

(vi) where a person has made a testamentary gift to a charity, he shall, for the purpose only of determining whether a person is a member of a related group, be deemed to have made the gift immediately before his death,

except that a charity is not a major donor of another charity which it does not control if the aggregate of its gifts to the other charity, in any taxation year commencing after 1983, is not more than $\frac{1}{3}$ of the aggregate of all its gifts in that year;

(c) "non-qualified investment" of a charity means

(i) a debt owing to the charity by

(A) a person who is a member, shareholder, trustee, settlor, officer, official, director or major donor of the charity, or any other person who does not deal at arm's length with any such person,

(B) a corporation controlled either by the charity, by any person referred to in clause (A) or by any combination thereof, or

(C) another charity, other than a registered charity, to which it is related,

but does not include a pledge or undertaking to make a gift to the charity, and

(ii) the shares of the capital stock of a corporation referred to in clause (i)(B), other than shares owned by the charity which are listed on a prescribed stock exchange in Canada,

and, for the purpose of this paragraph, a corporation controlled by the charity shall not include a limited dividend housing corporation or a corporation whose operations are confined to the holding of property used by the charity in its administration or in carrying on its charitable activities;

(d) "qualified donee" means a donee described in any of subparagraphs 110(1)(a)(i) to (vii) or paragraph 110(1)(b);

(e) "registered charity" means (i) a charity that is resident in Canada and was either created or established in Canada, or (ii) a branch, section, parish, congregation or other division of a charity described in subparagraph (i) that receives donations on its own behalf,

that has applied to the Minister in prescribed form for registration, that has been registered or re-registered and whose last registration has not been revoked under subsection 168(2);

(f) "related business" in relation to a charity means a business that is related to the objects of the charity and includes a business that is unrelated to

"non-qualified investment"

"qualified donee"

"registered charity"

"related business"

its objects if substantially all of the people employed in the carrying on of that business are not remunerated for such employment;

"specified gift"

(g) "specified gift" means a gift, the fair market value of which was not less than \$1,000 at the time of the gift, made after December 31, 1982; and

"taxation year"

(h) "taxation year" of a registered charity means its fiscal period.

Related charities

(2) For the purposes of this section, section 160.3 and Part V, a charity is related to another charity in a taxation year, except where both charities are components of the same religious denomination, if

(a) at any time in the year major donors common to both charities have contributed, in the aggregate, not less than 10% of the fair market value of all gifts made to each of the charities up to and including that time,

(b) one charity was created or established to further the purpose of the other,

(c) one charity is at any time in the year a major donor of the other, or

(d) at any time in the year one charity did not deal at arm's length with the other.

Idem

(3) For the purposes of this section and Part V, charities that are related to the same charity shall be deemed to be related to each other.

Idem

(4) For the purposes of this section and Part V, where there is within a group consisting of two or more charities a pattern of making significant gifts from one member of the group to another and

(a) the aggregate of the disbursement quotas of the members for taxation years ending in a calendar year, determined without reference to gifts received from members of the group exceeds

(b) the aggregate of amounts disbursed by the members on charitable activities and as gifts to qualified

donees, other than gifts to members of the group, for taxation years ending in that calendar year,

a charity within the group shall, if the Minister so directs, be deemed to be related to one or more charities within the group for such taxation years as he specifies.

(5) Where a charity satisfies more than 50% of its disbursement quota by making gifts to one or more registered charities each of which in turn satisfies more than 50% of its disbursement quota by making gifts to one or more registered charities, such of those charities as the Minister may designate shall, if he so directs, be deemed to be related for such taxation years as he specifies.

(6) Where a particular charity would otherwise be related to one or more other charities and it is established to the satisfaction of the Minister that

Charities deemed not to be related

(a) the charities are operated as separate entities even though one charity operates, administers or otherwise controls the other, or

(b) the relationship between the charities

(i) arises solely as a consequence of the particular charity providing funds required to establish a new charity (including the establishment of a major new program for an existing charity), and

(ii) is such that it is reasonable to consider that, after the satisfactory establishment of the new charity, the particular charity will significantly reduce its level of funding thereto,

such of those charities as the Minister designates shall, if he so directs, be deemed not to be related, for such taxation years as he specifies.

(7) The Minister may, in the manner described in section 168, revoke the registration of a charity

Revocation of registration of a charity

(a) for any reason described in subsection 168(1),

(b) where the charity carries on a business that is not a related business of that charity, or

(c) where, after May 1983, the charity acquired control of any corporation other than a corporation whose operations are confined to the holding of property used by or on behalf of the charity in administration or in carrying on charitable activities.

Minister may approve accumulation of property

(8) A registered charity may, with the approval in writing of the Minister, accumulate property for a particular purpose in the amount and for the period specified by the Minister in the approval, and any property accumulated after receipt of such approval and in accordance therewith shall be deemed to have been disbursed on charitable activities carried on by the charity in the taxation year in which it was so accumulated and not to have been disbursed in the taxation year in which it was used for the particular purpose.

Where accumulated property not used for approved purpose

(9) Where a registered charity has accumulated property as described in subsection (8) and that property, or some part of it, was not or ceased to be used for the particular purpose for which its accumulation was approved, the charity shall be deemed to have received a gift from a charity related to it equal to the portion of the amount of the property so accumulated that was not, or that ceased to be, so used in the second taxation year following

(a) in the case of property that was not used for the particular purpose, the earlier of the taxation year in which

- (i) the period specified by the Minister in his approval expired, and
- (ii) the charity decided not to so use the property; and

(b) in the case of property that ceased to be used for the particular purpose, the taxation year in which the charity ceased to so use the property.

Where corporation deemed to be controlled by charity

(10) For the purposes of this section and Part V, a corporation shall be deemed to be controlled by a charity if it

is controlled by the charity and persons or partnerships with whom the charity does not deal at arm's length, but a charity shall be deemed not to have acquired control of a corporation if it has not purchased or otherwise acquired for consideration more than 5% of any class of the shares of the capital stock of the corporation.

(11) Every registered charity shall, within 4 months after the end of each taxation year of the charity, file with the Minister both an information return and a public information return for the year, each in prescribed form and containing prescribed information, without notice or demand therefor.

Charity to file returns

(12) Notwithstanding section 241,

(a) the information contained in a public information return referred to in subsection (11) shall be communicated or otherwise made available to the public by the Minister in such manner as he deems appropriate; and

Minister to make information available to public

(b) the Minister may make available to the public in such manner as he deems appropriate an annual listing of all registered or previously registered charities indicating for each the name, location, registration number, date of registration and, in the case of a charity the registration of which has been revoked, annulled or terminated, the effective date of such revocation, annulment or termination.

(13) Where the registration of a charity is revoked in the manner described in section 168, the charity shall, on or before the day that is one year after the day on which such revocation is effective, pay a special tax under this Part equal to the amount by which

Payment of tax where registration of charity revoked

(a) the fair market value of all its assets on the date that notice of the Minister's intention to revoke its registration is mailed,

exceeds the aggregate of

(b) the fair market value on that date of any assets of the charity transferred

by it after that date and within one year from the date of revocation to a qualified donee,

(c) amounts paid by the charity after the date referred to in paragraph (a) in respect of *bona fide* debts of the charity that were outstanding on that date, and

(d) the amount of such reasonable expenses as are incurred by the charity within the period described in paragraph (b).

(14) A person, other than a qualified donee, who, on or after the day that notice of the Minister's intention to revoke the registration of a charity is mailed, receives any amount from that charity, other than an amount for which consideration equal to fair market value is given, is jointly and severally liable with the charity for that portion of the tax imposed on the charity by subsection (13) that is equal to the amount by which

(a) the amount received by him from the charity, exceeds

(b) the aggregate of amounts received by him from the charity each of which is an amount described in paragraph (13)(c) or (d).

(15) Where a debt, other than a debt to which subsection 80.4(1) applies, owing by a taxpayer to a registered charity at any time during the taxpayer's taxation year was a non-qualified investment of the charity, the taxpayer shall be deemed to have received a benefit in the year with respect to that debt equal to twice the amount, if any, by which

(a) the amount of interest on the debt for the year determined under subsection (16) exceeds

(b) the amount of interest on the debt for the year paid not later than 30 days after the end of the year.

(16) For the purpose of paragraph (15)(a), where a debt to a registered charity

(a) was incurred before April 22, 1982 and has not been extended or renewed on or after that date, interest on the debt for a particular calendar year shall be computed

(i) before the date on which the rate determined in this subparagraph first equals or exceeds the prescribed rate, at a rate per annum equal to 6% plus 2% for each calendar year after 1982 and before the particular year, and

(ii) on and after the date referred to in subparagraph (i), during the period in the year that the debt was outstanding, at the prescribed rate per annum, and

(b) was incurred, extended or renewed at any time after April 21, 1982, interest thereon shall be computed after that time, during the period in the year that the debt was outstanding, at the prescribed rate per annum.

(17) Where a share of the capital stock of a corporation owned by a registered charity was during the corporation's taxation year a non-qualified investment of the charity, the corporation shall be deemed to have received a benefit in the year with respect to that share equal to twice the amount, if any, by which

(a) the amount that would be the interest for the year on a debt based on the assumption that

(i) the amount of such a debt was equal to

(A) in the case of an investment acquired before April 22, 1982, the greater of the fair market value of the share on April 21, 1982, and the cost amount to the charity of the share, or

(B) in any other case, the cost amount to the charity of the share, (ii) such debt was outstanding throughout the period in the year

Computation of interest on debt

Others liable for payment of tax

Deemed benefit to taxpayer from debt

Deemed benefit to corporation from share

that the share was owned by the charity, and

(iii) interest thereon was determined under subsection (18)

exceeds

(b) the aggregate of all amounts each of which is a dividend, other than a stock dividend, received by the charity from the corporation in the year on the share.

(18) For the purpose of subparagraph (17)(a)(iii),

(a) in any case where a share was acquired by a charity before April 22, 1982 and has been owned continuously by it since that date, interest for a particular calendar year shall be computed

(i) before the date on which the rate determined in this subparagraph first equals or exceeds the rate determined under paragraph (b), at a rate per annum equal to 4% plus 1% for each 5 calendar years contained in the period commencing after 1982 and ending before the particular year, and

(ii) on and after the date referred to in subparagraph(i), during the period in the year that the share was owned, at two-thirds of the prescribed rate per annum, and

(b) in any other case, interest shall be computed during the period in the year that the share was owned, at two-thirds of the prescribed rate per annum,

and, for the purpose of this subsection, where a share is acquired by a charity pursuant to a transaction after April 21, 1982 to which section 86 or 87 applied, that share shall be deemed to be the same share as the share for which it was substituted."

(2) Subsection (1) is applicable to taxation years commencing after 1983.

4. (1) All that portion of subsection 150(1) of the said Act preceding paragraph

(a) thereof is repealed and the following substituted therefor:

"150. (1) A return of the income for each taxation year in the case of a corporation (other than a corporation that was a registered charity throughout the year) and for each taxation year for which a tax is payable in the case of an individual shall, without notice or demand therefor, be filed with the Minister in prescribed form and containing prescribed information,"

(2) Subsection (1) is applicable to the 1983 and subsequent taxation years.

5. (1) The said Act is further amended by adding thereto, immediately after section 160.2 thereof, the following section:

"160.3 (1) Where a registered charity (in this section referred to as the "taxable charity") has become liable for tax for a year under Part V, each registered charity related to it (in this section referred to as the "related charity") shall be jointly and severally liable, together with the taxable charity, to pay that part of such tax as does not exceed the amount of gifts received by it from the taxable charity after the year in respect of which the tax became payable, but nothing in this subsection shall be deemed to limit the liability of a charity under any other provision of this Act.

(2) The Minister may at any time assess a registered charity in respect of any amount payable under this section and the provisions of this Division are applicable, with such modifications as the circumstances require, in respect of an assessment made under this section as though it had been made under section 152.

(3) Where one or more related charities have, by virtue of subsection (1), become jointly and severally liable in respect of part or all of a liability under this Act of a taxable charity, a payment by any such related charity on account of its joint and several liability shall to the extent of the payment discharge that liability, but the

Returns

Joint liability of related registered charities for payment of tax

Minister may assess registered charity

Rules where one or more related charities jointly liable

Computation of interest with respect to a share

liability of any such related charity is not reduced by the amount of any payment by another charity or other person except to the extent that such payment reduces the liability of the taxable charity to an amount less than the amount in respect of which such related charity was, by subsection (1), made jointly and severally liable."

(2) Subsection (1) is applicable to taxation years commencing after 1983.

6. (1) Subsection 168(2) of the said Act is repealed and the following substituted therefor:

Revocation of
registration

"(2) Where the Minister gives notice under subsection (1) to a registered charity or a registered Canadian amateur athletic association,

(a) if the charity or association has applied to him in writing for the revocation of its registration, the Minister shall, forthwith after the mailing of the notice, publish a copy thereof in the *Canada Gazette*, and

(b) in any other case, the Minister may, after the expiration of 30 days from the day of mailing of the notice, or after the expiration of such extended period from the day of mailing of the notice as the Federal Court of Appeal or a judge thereof, upon application made at any time before the determination of any appeal pursuant to subsection 172(3) from the giving of the notice, may fix or allow, publish a copy of the notice in the *Canada Gazette*,

and upon such publication of a copy of the notice, the registration of the charity or association is revoked."

(2) Subsection (1) is applicable to taxation years commencing after 1983.

7. (1) The said Act is further amended by adding thereto, immediately after Part IV thereof, the following Part:

"PART V

TAX IN RESPECT OF REGISTERED CHARITIES

188. (1) In this Part and section 149.1,

Definitions

(a) "correction period" in respect of an assessment means the period ending 90 days after the date of a notice of assessment of the tax payable under subsection (3) or such longer period as the Minister may specify in respect of the assessment;

"correction
period"

(b) "disbursement quota" of a registered charity for a particular taxation year means the aggregate of

10 "disbursement
quota"

(i) the aggregate of all amounts each of which is a gift received by it in the particular year from a charity related to it other than

(A) a gift of tangible capital property to the extent that it is used exclusively and directly in charitable activities or administration, or

(B) a gift out of capital,

and, for the purposes of this subparagraph, where at any time in the immediately preceding taxation year a property or part thereof described in clause (A) previously received by the charity from a charity related to it ceases to be used in the manner described in clause (A), such property or part thereof shall be deemed to be a gift received in the year from a charity related to it the amount of which shall be deemed to be its fair market value at that time,

(ii) the aggregate of all amounts each of which is an amount received by it in the particular year on account of a loan or other debt obligation arising in the course of its charitable activities or administration,

(iii) 80 % of the amount by which the aggregate of all amounts each of which is a gift received by it in the immediately preceding taxation year exceeds the aggregate of all

amounts each of which is the amount of a gift received by it in that year that was

(A) a gift from a charity related to it, 5

(B) a gift, other than one received from a qualified donee, that was subject to a trust or direction to the effect that the property given, or property substituted therefor, 10 was to be held by the charity for a period of not less than 10 years from its date of receipt,

(C) a gift, other than one received from a qualified donee, that was 15 subject to a trust or direction to the effect that the property given, or property substituted therefor, was to be used by the charity over a period not exceeding 10 years 20 from its date of receipt,

(D) a testamentary gift the terms of which do not require its expenditure over less than 10 years,

(E) a gift out of capital, or 25

(F) a gift of tangible capital property to the extent that it was used by the charity exclusively and directly in charitable activities or administration, 30

and for the purpose of this subparagraph, a gift described in any of clauses (A) to (F) shall not be included in any other clause of this subparagraph, 35

(iv) the aggregate of all amounts each of which is, for each of the taxation years immediately following the receipt of a gift described in clause (iii)(C), but not exceeding the number of years specified in respect of the gift, 80% of the quotient obtained when the amount of the gift is divided by the number of years specified in respect of such gift, 40 45

(v) in each of the first ten years to which this Part applies, a portion of the amount, if any, by which

(A) 90% of the amount, if any, deducted by the charity in its last 50 taxation year commencing before 1984 pursuant to paragraph

149.1(18)(a) as it then read exceeds the amount determined under subparagraph (iii) in its first taxation year commencing after 1983 5

exceeds

(B) the aggregate of amounts included, under this subparagraph, in the disbursement quota of previous taxation years 10

that is not less than the amount obtained when the excess of the amount in clause (A) over that in clause (B) is divided by the difference between 10 and the number of 15 previous taxation years of the charity commencing after 1983 and before the particular year, and

(vi) the proportion of 4.5% of the amount, if any, by which 20

(A) the value, determined in accordance with subsection (2), at the beginning of the particular year, of all properties of the charity at that time other than the portion 25 of tangible capital properties of the charity that, since their acquisition by the charity, have been used exclusively and directly in charitable activities or administra- 30 tion

exceeds

(B) the aggregate of amounts each of which is an amount determined in respect of the charity 35 under subparagraph (iii) or (iv) for the particular year

that the number of days in the taxation year is of 365, except that where the aggregate of all amounts each of 40 which is an amount determined under this subparagraph for the charity or any charity related to it is less than \$250,000 and, in the immediately preceding year, the 45 charity has made qualified disbursements not more than 25% of which consist of gifts to qualified donees, the amount determined for the charity under this subparagraph shall be 50 deemed to be nil;

"gift out of capital"

"qualified disbursements"

(c) "gift out of capital" means a gift made in a year to a qualified donee by a registered charity as donor where

(i) the gift was designated by the donor in that year as a gift out of capital, and

(ii) the donor was not liable for tax under subsection (3) in that year;

(d) "qualified disbursements" made by a registered charity for a taxation year at any particular time means the amount, if any, by which the aggregate of

(i) the aggregate of all amounts each of which is the amount of a disbursement made by it in the year before the particular time on charitable activities, including the administrative expenses related thereto, carried on by it,

(ii) the aggregate of all amounts each of which is the amount of a gift made by it in the year before the particular time to a qualified donee other than

(A) a gift out of capital, or

(B) a gift made to a related charity,

(iii) the aggregate of all amounts each of which is the amount of a disbursement made by it in the year on account of a loan or other debt obligation arising in the course of its charitable activities or administration, and

(iv) the amount, if any, obtained by subtracting

(A) the aggregate of all amounts each of which is a gift received by it in the year before the particular time from a charity related to it other than a gift out of capital by the donor

from

(B) the aggregate of all amounts each of which is a gift made by it to a related charity in the year other than a gift out of capital

exceeds

(v) that portion of the amount that is the aggregate of all amounts each of

which is an amount determined under subparagraph (i) or (ii) for the year that has been designated by the charity before the particular time for the purposes of subsection (4); and

(e) "unused excess qualified disbursements" of a registered charity for a taxation year at a particular time means the amount, if any, by which

(i) the amount by which its qualified disbursements for the year as determined at the end of the year exceeds its disbursement quota for the year

exceeds

(ii) the aggregate of all amounts each of which is the portion of the amount determined under subparagraph (i) for the year that before that time has reduced the amount of tax payable by it under subsection (3) or (4).

(2) For the purposes of clause (1)(b)(vi)(A), the value of all properties of a charity at the beginning of a particular year is an amount equal to the quotient obtained when

(a) the amount by which the aggregate of

(i) the aggregate of all amounts each of which is the value, determined in prescribed manner, of a property (other than the portion of a tangible capital property used exclusively and directly in charitable activities or administration of a charity) on hand at the end of a number of consecutive equal periods (not exceeding eight) totalling 24 months and ending immediately before the beginning of the year, and

(ii) where the charity has received a gift out of capital from a related charity in the 24 months ending immediately before the beginning of the year, the aggregate of all amounts each of which is an amount equal to the product obtained when the amount of the gift is multiplied by the number of equal periods deter-

"unused excess qualified disbursements"

Value of properties of charities at beginning of year

mined under subparagraph (i) that had ended before the particular gift was received

exceeds

(iii) where the charity has made a gift out of capital to a related charity in the 24 months ending immediately before the beginning of the year, the aggregate of all amounts each of which is an amount equal to the product obtained when the amount of the gift is multiplied by the number of equal periods determined under subparagraph (i) that had ended before the particular gift was made

is divided by the number of equal periods determined under subparagraph (i) and, for the purposes of this subsection,

(b) the charity shall be deemed to have existed at the end of each equal period, and

(c) where a charity has selected a number of equal periods for a taxation year under subparagraph (a)(i), it shall use the same number of periods in each subsequent taxation year unless the Minister has approved in writing a change in the number of such periods.

(3) A registered charity shall, for each taxation year commencing after 1983, pay a tax equal to 15% of the amount (in this section referred to as the "taxable base" of the charity), if any, by which

(a) the amount, if any, by which its disbursement quota for the year exceeds its qualified disbursements for the year at the end of the year

exceeds

(b) the aggregate of its unused excess qualified disbursements at the end of the year for each of its five immediately preceding taxation years.

(4) A registered charity shall, for each taxation year commencing after 1983, pay a tax equal to 100% of the amount by which the taxable base of the charity for the particular year exceeds the aggregate of all amounts each of which is

(a) the aggregate of all amounts each of which is the unused excess qualified disbursements of the charity for a taxation year commencing after the particular year and ending before the time a notice of assessment is issued in respect of the tax payable by it under subsection (3) for the particular year;

(b) such part as the charity designates of its disbursements that would, but for subparagraph (1)(d)(v), be qualified disbursements of the charity for the taxation year in which the notice of assessment referred to in paragraph (a) is issued, determined at the earlier of

- (i) the end of that taxation year, and
- (ii) the end of its correction period in respect of the assessment; and

(c) where the charity's correction period in respect of an assessment ends after the end of the taxation year in which the notice of assessment referred to in paragraph (a) is issued, such part as the charity designates of its disbursements that would, but for subparagraph (1)(d)(v), be qualified disbursements of the charity for the taxation year in which the correction period ends, determined at the end of the correction period.

(5) Where tax under subsection (3) has been paid for a taxation year by a registered charity and all or any part of that tax arises from an incorrect valuation of the property of the charity in determining its disbursement quota and that incorrect valuation was not made knowingly or under circumstances amounting to gross negligence, the Minister shall, after assessing the return for the year required to be filed under subsection (8), refund such part of the tax that is attributable to the incorrect valuation except to the extent that tax is payable by the charity for the year under subsection (4).

(6) For the first taxation year commencing after 1983 of a charity that has been registered by the Minister for a taxation year commencing before 1984, the

Payment of tax
by registered
charity

Refund of tax
where property
valuation
incorrect

Disbursement
quota of a
charity

Idem

disbursement quota of that charity is the lesser of

(a) the amount otherwise determined for the charity for that year under paragraph (1)(b), and

(b) the value determined in prescribed manner at the beginning of the taxation year of all properties of the charity at that time other than those tangible capital properties used exclusively and directly in charitable activities or administration.

(7) Every registered charity liable to pay tax under subsection (3) for a taxation year shall on or before the day on or before which an information return under Part I is required to be filed by it for the year

(a) file with the Minister a return for the year in prescribed form and containing prescribed information, without notice or demand therefor;

(b) estimate in the return the amount of tax payable under subsection (3) by the charity for the year; and

(c) pay to the Receiver General the amount of tax payable under subsection (3) by it for the year.

(8) Every registered charity liable to pay tax under subsection (3) for a taxation year shall on or before the day that is thirty days after the end of its correction period for the year

(a) file with the Minister a return for the year in prescribed form and containing prescribed information, without notice or demand therefor;

(b) estimate in the return the amount of tax, if any, payable under subsection (4) by the charity for the year;

(c) estimate in the return the amount of any refund under subsection (5) to which it is entitled; and

(d) pay to the Receiver General the amount of any tax payable under subsection (4) by it for the year.

(9) Subsections 150(2) and (3), sections 152 and 158, subsection 161(1)

and sections 162 to 167 and Division J of Part I are applicable to this Part with such modifications as the circumstances require."

(2) Subsection (1) is applicable to taxation years commencing after 1983.

8. (1) The definition "registered charity" in subsection 248(1) of the said Act is repealed and the following substituted therefor:

"'registered charity' has the meaning assigned by subsection 149.1(1);"

(2) Subsection (1) is applicable to taxation years commencing after 1983.

PROPOSED AMENDMENTS TO THE INCOME TAX REGULATIONS WITH RESPECT TO CHARITIES

X. (1) For the purposes of subparagraph 188(2)(a)(i) and paragraph 188(6)(b) of the Act, the value of property of a charity on hand at the end of a particular period shall be

(a) for property that is a non-qualified investment, the amount that is the greater of its cost amount to the charity or its fair market value at that time,

(b) for property, other than a non-qualified investment, that is

(i) a marketable security, the amount that is its fair market value at that time,

(ii) money (other than money the fair market value of which exceeds its stated value as legal tender) and deposits of such money with an institution authorized by the laws of a government to accept such deposits, the amount thereof,

(iii) a share in a private corporation or an interest in real property, the amount that is the fair market value of the property as determined by

(A) an independent appraisal, acceptable to the Minister, made as of a date not more than three years before that time, or

Registered
charity to file
return and pay
tax

Idem

Provisions
applicable

(B) any other method acceptable to the Minister,

less the amount of any debt owing that is secured by the real property,

(iv) property owned in connection with the charitable activities of the charity that is shares of a limited dividend housing corporation, low interest and interest-free loans, or shares in a co-operative credit society, the object of which is to make low interest or interest-free loans, the amount such that the actual return on the property, if any, will be 4.5% per annum of that amount, 15

(v) a life insurance policy, other than an annuity contract, the cash surrender value of the policy at that time,

(vi) an annuity contract, its accumulating fund determined in prescribed manner at that time, 20

(vii) a pledge of contributions or a gift received by it that is a future interest in a trust or estate, nil, and

(viii) property not otherwise described in this paragraph or paragraph (a), the amount that is the fair market value of the property as determined by 25

(A) an independent appraisal, acceptable to the Minister, made as of a date not more than one year before that time, or 30

(B) any other method acceptable to the Minister.

Explanatory Notes

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50
51
52
53
54
55
56
57
58
59
60
61
62
63
64
65
66
67
68
69
70
71
72
73
74
75
76
77
78
79
80
81
82
83
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
100

Explanatory Notes

ITA
56(1) Paragraph 56(1)(w) is added to include in the income of an individual or corporation the benefit calculated under subsection 149.1(15) or (17) with respect to a loan received from or any share issued to a registered charity which is a non-qualified investment of the charity.

ITA
110(8)(c) The definition "registered charity" is transferred from paragraph 110(8)(c) of the existing Act to new paragraph 149.1(1)(e). The definition is changed only in minor respects.

ITA
149.1(1)(a) The definition of a "charity" in paragraph 149.1(1)(a) consolidates and expands upon the existing definitions of "charitable foundation" and "charitable organization" for which separate definitions will no longer be required. The existing definition requires that no part of the income of a charity may be made available to specified persons. There are several changes to this requirement. First, the reference to "income" is replaced by "property". Second, the list of specified persons to whom property may not be made available has been expanded to include administrators, officers of the charity, major donors to the charity and any person who does not deal at arm's length with any member of the enlarged list. The definition also is amended to require not only that the property of the charity is not made available for the personal use or benefit of certain specified persons, but also that it is not transferable to any such person. Subparagraph (iv) provides that this requirement will not be offended where the charity pays an amount for services or property that is not in excess of fair market value.

ITA
149.1(1)(b) Paragraph 149.1(1)(b) defines "major donor". This expression is relevant for the definitions of "charity" and "non-qualified investment" and for the purposes of determining when charities are related under subsection 149(2).

The major donors of any charity will be those persons or members of a group of related persons who, after December 31, 1982, have contributed, in gifts of \$1,000 or more, more than 10 per cent of all gifts which the charity receives after that date. For the purpose of this definition, gifts include the outstanding balance of loans made by persons who are not in the business of making loans. They also include the amount by which the fair market value of property transferred to a charity exceeds any consideration given by the charity. It should be noted that, for the purpose of determining whether or not persons will be treated as members of a related group, a testamentary gift will be considered to have been made immediately before the death of the donor.

The major donor of a charity includes any person who is related to a major donor. It also includes the major donors of another charity which is a major donor of the particular charity. A charity will be a major donor of another charity only if its gifts in a year to the recipient charity constitute more than one-third of all of the gifts that it makes in the year.

A special rule applies where a charity was a private foundation in the last year before the new system comes into force. In this case its major donors will be those

persons or members of a group of related persons whose contributions to capital disqualified the charity as a public foundation. The major donors determined in that last year will maintain their status as major donors until their contributions to capital are less than 10 per cent of all such contributions up to any particular time.

ITA
149.1(1)(c)

Paragraph 149.1(1)(c) provides a definition of "non-qualified investment." The definition of "qualified investment" in the existing Act, which applies only to private foundations, is dropped and the term "non-qualified investment", applicable to all charities, replaces it. "Non-qualified investment" includes those shares, bonds and any other debt obligations held by a charity which have a potential for self-dealing with any of a specified list of persons that are or may be in a position to control the charity. Subsections 149.1(15) and (17) provide penalties where non-qualified investments fail to produce the rate of return stipulated in those subsections. Excluded from this definition are shares which are listed on a prescribed Canadian stock exchange and debts owing by or shares in a limited dividend housing corporation or a corporation whose sole purpose is to hold property to be used by the charity in its activities or administration.

ITA
149.1(1)(d)

Paragraph 149.1(1)(d) provides the definition of "qualified donee". It is unchanged from the existing definition in paragraph 149.1(1)(h) of the Act and includes any of those organizations a gift to which is deductible under paragraph 110(1)(a) or (b) of the Act.

ITA
149.1(1)(e)

The definition of "registered charity" in paragraph 149.1(1)(e) replaces the existing definition in paragraph 110(8)(c). Although essentially unchanged, the definition now also covers the situation in which a charity is re-registered.

ITA
149.1(1)(f)

Paragraph 149.1(1)(f) provides the definition of "related business" which is relevant for the purposes of the definition of "charity" in paragraph 149.1(1)(a). Under that definition a charity is entitled to carry on a related business.

Under the existing Act a "related business" is defined to include an unrelated business of a charity where substantially all the people employed by it are not remunerated for their services. This definition has been modified slightly to clarify that those persons employed in the business may not be remunerated for their services either by the charity itself or by any other person.

ITA
149.1(1)(g)

The definition of "specified gift" is relevant for the purposes of the definition "major donor" in paragraph 149.1(1)(b). In determining whether a person who has made contributions to a charity qualifies as a major donor, only those gifts in excess of \$1,000 are taken into account.

ITA
149.1(1)(h)
ITA
149.1(2)

Paragraph 149.1(1)(h) defines the "taxation year" of a charity as its fiscal period.

Subsections 149.1(2) to (6) set forth the circumstances in which one charity will be considered to be related to another charity. The concept of related charity is relevant to the calculation of the disbursement quota and qualified disbursements of a charity under paragraphs 188(1)(b) and (d). Under subsection 149.1(2) two charities will be considered to be related if they do not deal with each other at arm's length or if one charity is formed to further the purposes of the other. In addition two or more charities will be considered as related where they have common major donors who together have contributed 10 per cent or more of all gifts received by each of the related charities.

ITA
149.1(3)

Under subsection 149.1(3) two or more charities will be considered to be related where they are related to the same charity.

ITA
149.1(4)

Subsection 149.1(4) authorizes the Minister of National Revenue to treat two or more charities in a group as related charities in those circumstances where there is a pattern of gifting as between the charities such that, when these gifts are excluded, the charities would fail to meet the combined disbursement quotas of all of the charities within that group.

ITA
149.1(5)

Subsection 149.1(5) is another anti-avoidance provision that applies in those circumstances where a succession of charities satisfy their disbursement quotas by making gifts to qualified donees. The provision is necessary where a charity in the chain through which the funds flow subsequently ceases to exist. Without this rule it would be possible to structure an arrangement in such a way that the funds given to a charity are never actually spent on charitable activities. In these circumstances, the Minister of National Revenue may treat the charities as related for such years as he considers appropriate.

ITA
149.1(6)

Subsection 149.1(6) is a relieving provision which enables the Minister of National Revenue to declare that a charity is not related to another charity in circumstances where they would be otherwise related under the provisions of subsection 149.1(2). This relief may be given where a charity is administered or controlled by another charity but essentially operates as a separate entity. The relief also may be extended where one charity provides the necessary seed capital to fund another charity or a new charitable activity, thereby becoming a major donor, if the Minister is satisfied that this is a temporary situation.

ITA
149.1(7)

Subsection 149.1(7) combines all of the circumstances which can lead to the deregistration of a charity found in subsections 149.1(2), (3) and (4) of the existing Act. The Minister may revoke the registration of a charity

- where it has requested revocation, has ceased to qualify as a charity or falls within any of the other circumstances enumerated in subsection 168(1), or
- where it carries on a business other than a related business as defined in paragraph 149.1(1)(f).

However, failure to meet its disbursement quotas will no longer be grounds for the deregistration of a charity. Instead, special taxes are provided under subsections 188(3) and (4) of the Act where a charity fails to meet its disbursement quota. Further, the rules in subsection 149.1(7) clarify that a charity will not be deregistered for carrying on a related business or for incurring debt. The existing prohibition against a foundation acquiring control of a corporation is extended under this subsection to apply to all charities.

ITA
149.1(8)

Subsection 149.1(8) allows a charity which obtains Ministerial approval to accumulate funds for a particular purpose. Funds so accumulated by a charity in any particular year are treated as qualified disbursements for purposes of meeting its disbursement quota requirements. This subsection will continue in substance the provisions in subsection 149.1(8) of the existing Act. However, income earned on the property accumulated is no longer automatically included in an authorized accumulation. Such income will have to be specifically designated for purposes of the accumulation.

| | |
|------------------|--|
| ITA
149.1(9) | <p>Subsection 149.1(9) is an amended version of the provision found in subsection 149.1(9) of the existing Act. It provides that where a charity ceases to use or decides not to use property for the purpose for which it was accumulated, the property will be treated in the second year following such a decision as a gift received from a related charity. Accordingly, in that year an amount equal to 100 per cent of the value of the property must be disbursed on charitable activities or on gifts to qualified donees. This reflects the fact that the property is treated under subsection 149.1(8) during the accumulation period as a disbursement on charitable activities. The two-year deferral period is intended to allow time for the charity to plan an alternative use for the property.</p> |
| ITA
149.1(10) | <p>Subsection 149.1(10) sets out the circumstances in which a charity is deemed to control a corporation for purposes of the provisions relating to the deregistration of a charity in new subsection 149.1(7). This is a modification of the provision, currently applicable only to foundations, in paragraph 149.1(12)(a) of the existing Act. A charity will not be considered to have acquired control of a corporation for this purpose if it has not purchased more than 5 per cent of any class of the corporation's shares.</p> |
| ITA
149.1(11) | <p>Subsection 149.1(11) continues subsection 149.1(14) of the existing Act relating to the filing of information and public information returns. The time within which the returns of a charity are required to be filed has been extended to four months from the end of its taxation year. Under the existing Act, such returns are required within three months from the year-end.</p> |
| ITA
149.1(12) | <p>Subsection 149.1(12) continues subsection 149.1(15) of the Act and authorizes the Minister to make available to the public a list of all registered charities and the information contained in their public information returns. This provision is unchanged from subsection 149.1(15) of the existing Act.</p> |
| ITA
149.1(13) | <p>Subsection 149.1(13) applies a special tax following a revocation of a charity's registration. The tax is the value of the assets that have not been, within one year from the date on which the revocation is effective,</p> <ul style="list-style-type: none"> • transferred to other registered charities, • used to repay any debts, or • used to cover the normal expenses of the charity. |
| ITA
149.1(14) | <p>Subsection 149.1(14) imposes a tax liability, jointly with a deregistered charity, on persons, other than qualified donees, who receive property of the charity where registration has been revoked. This subsection is similar to subsection 149.1(17) of the existing Act.</p> <p>There is an important change, however, which prevents a person from becoming liable under this subsection where he has purchased property from or rendered services to the charity for fair market value.</p> |
| ITA
149.1(15) | <p>Subsection 149.1(15) is a new provision. It provides for the calculation of the amount of the benefit required by paragraph 56(1)(w) to be included in the income of a taxpayer who owes money to a registered charity on indebtedness that is a non-qualified investment of the charity. The expression non-qualified investment is defined in paragraph 149.1(1)(c) and the purpose of the inclusion is to ensure that</p> |

the charity receives a reasonable rate of interest on its investments. This is achieved by treating a benefit as arising wherever a taxpayer has paid less than the required interest to a charity on a non-qualifying debt. The benefit is twice the difference between the interest actually paid on the debt to the charity and the interest thereon determined under subsection 149.1(16). The effect of doubling this difference is, in the case of a person in the 50 per cent tax bracket, to eliminate all of that benefit. Excluded from this provision are employee loans to which the rules in section 80.4 apply.

ITA
149.1(16)

Subsection 149.1(16) provides the mechanics for calculating the interest that is required to be paid by a taxpayer on a non-qualifying debt to avoid having a benefit attributed to him under subsection 149.1(15). Where the debt is issued after April 21, 1982 or was issued before that date and the terms later modified, interest is to be calculated at the prescribed rate. The prescribed rate will be the rate of interest that is charged on tax deficiencies and paid on tax refunds. A transitional rule is provided where the debt was incurred before April 22, 1982 and has not been modified since that date. For such debt the rate is 6 per cent per annum, increasing 2 percentage points for 1984 and every year thereafter until such time as this transitional rate either equals or exceeds the prescribed rate. After that time, the prescribed rate is to be used in calculating the amount of the benefit.

ITA
149.1(17)

Subsection 149.1(17) deals with shares owned by a charity and is the complement to subsection 149.1(15) that deals with debt. Subsection (18) provides the mechanics for calculating the benefit required by paragraph 56(1)(w) to be included in the income of a corporation whose shares are held by a registered charity as a non-qualified investment. The calculation of this benefit for non-qualifying shares is somewhat more complex than that for non-qualifying debt. Notionally, the shares are treated as if they were debt having a face value equal to, in the case of shares acquired before April 22, 1982, the greater of the fair market value of the shares on April 21, 1982 and their cost base to the charity. In the case of shares acquired after April 21, 1982, when the new rules relating to non-qualified investments were first announced, the value of the shares will be their cost base to the charity. The benefit is then deemed to be twice the difference between the amount of the dividends (other than stock dividends) actually paid on the shares and the rate of interest as determined under subsection 149.1(18). The effect of doubling the difference is to eliminate any benefit for corporations paying a combined federal and provincial tax at the 50 per cent rate.

ITA
149.1(18)

Subsection 149.1(18) provides the mechanics for determining the interest rate which should be payable on the non-qualifying shares that are treated notionally as debt in subsection 149.1(17). Where shares were acquired after April 21, 1982, the interest rate will be set at two-thirds of the prescribed rate. This is the rate of interest that is charged on tax deficiencies and paid on tax refunds. There is a transitional rule for shares acquired by a charity before April 22, 1982. For such shares, the rate is set at 4 per cent, increasing one percentage point in 1988 and every five years thereafter until such time as the transitional rate either equals or exceeds two-thirds of the prescribed rate. After that time, two-thirds of the prescribed rate shall apply in calculating the subsection 149.1(17) amount. For those shares acquired after April 21, 1982 that constitute a non-qualified investment of a charity, dividends will have to be paid in a year in an amount equal to two-thirds of the prescribed interest rate for the year for the corporation to avoid having a benefit imputed to it.

ITA
150(1)

Section 150 of the Act sets out the requirements relating to the filing of corporate tax returns. The amendment to subsection 150(1) removes registered charitable corporations from the scope of this section. The filing requirement for such corporations is now provided in subsection 149.1(11) which requires the returns for all registered charities to be filed within four months from the end of their year-end.

ITA
160.3

Sections 160 to 160.2 of the Act deal with joint and several tax liability. New section 160.3 provides that a registered charity will be jointly and severally liable for the tax payable under Part V by any other charity to which it is related. The Part V tax is a special tax imposed on a registered charity that fails to meet its disbursement quota – that is, one that has not devoted sufficient of its resources to charitable activities or for charitable purposes. Joint and several liability for the Part V tax is limited to the extent to which a charity has received gifts from another charity that in a previous year was liable for the tax. The provision prevents a charity from avoiding the payment of tax under Part V by arranging for the transfer of its property to a related charity.

ITA
168(2)

Section 168 of the Act deals with the revocation of the registration of registered charities. The amendments to subsection 168(2) simply replace the references to “organization” with references to “charity”. These changes are consequential on other amendments relating to registered charities.

Part V

This part provides for a two-stage tax on a charity that fails to meet its disbursement quota for a year. Previously such failure was grounds for deregistration.

The first stage is a tax of 15 per cent of the disbursement shortfall and this gives notice that the shortfall must be made up within a correction period by further disbursements. The second stage is a tax of 100 per cent of the shortfall to the extent the charity fails to make those further disbursements.

Subsection 188(1) of the Act sets out a number of definitions that are used in Part V and in the provisions relating to registered charities in section 149.1 of the Act.

ITA
188(1)(a)

Paragraph 188(1)(a) defines “correction period”. It is the 90 day period after the date of a notice of assessment of the 15 per cent tax payable under subsection 188(3) or such longer period to which the Minister may agree. This definition is relevant for the calculation and payment of the tax under subsection 188(4).

ITA
188(1)(b)

Paragraph 188(1)(b) of the Act defines the “disbursement quota” of a charity. It is the amount that a charity is required to expend annually on charitable activities or as gifts to qualified donees. The disbursement quota is the aggregate of

- 100 per cent of gifts received in the year from related charities – subparagraph (i),
- 100 per cent of amounts received as loans or in repayment of loans made by the charity – subparagraph (ii),
- 80 per cent of gifts received in the immediately preceding year, other than gifts from related charities – subparagraphs (iii) and (iv), and
- 4.5 per cent of the value of the charity's investments at the beginning of the year – subparagraph (vi).

There are a number of exclusions or adjustments in these categories which are described below.

Gifts from Related Charities: Excluded from the 100 per cent disbursement quota in subparagraph (b)(i) are gifts received out of the capital of another charity. The portion of gifts of property which are used "exclusively and directly" in charitable activities or administration also are excluded until such time as the property ceases to be so used. In this case, the fair market value of the property at the time it ceases to be so used will be added to the disbursement quota of the charity for the following year.

Loans: Moneys borrowed and payments received on moneys lent in connection with the charitable activities or administration of the charity are included in its disbursement quota under subparagraph (b)(ii). There is a corresponding provision in the definition of qualified disbursements in paragraph 188(1)(d).

Gifts other than from Related Charities: Under subparagraph (b)(iii) a charity is required to disburse 80 per cent of gifts received other than those received from related charities. This does not apply to gifts received out of the capital of another charity. Nor does it apply to the portion of any gifts of property which are used exclusively and directly in charitable activities or administration. To the extent that these latter gifts cease to be so used, they will fall into the pool of assets subject to the 4.5 per cent disbursement quota as provided in subparagraph (b)(vi). A third exclusion is for a gift to which the donor has attached a condition that it be retained by the charity for at least 10 years. (This exclusion currently is recognized under the existing rules only for charitable foundations.) A fourth exclusion is for a gift which the donor stipulates is to be used by the charity in its activities over a specified period not exceeding 10 years. (In this case a *pro rata* portion of the gift rather than its total value is required by subparagraph (b)(iv) to be included in the disbursement quota. This is determined by dividing 80 per cent of the amount of the gift by the number of years specified by the donor and including that amount in the disbursement quota of the charity in each of those years.) A specific exclusion is provided for testamentary gifts if there is no direction as to their use.

Investments: Subparagraph 188(1)(b)(vi) requires a charity to include in its disbursement quota an amount equal to 4.5 per cent of the value of its investments at the beginning of the year. Implicit in the calculation under this provision is the underlying assumption that charities spend gifts in the year following their receipt. Accordingly, it is assumed that the funds which are subject under subparagraphs (b)(iii) and (iv) to the 80 per cent disbursement quota will be on hand and included in the charity's pool of investment assets at the beginning of the year. If, as assumed, these funds are disbursed in the year, they would not be available to earn the 4.5 per cent required to be disbursed. Therefore, these funds are excluded from the investment pool on which the 4.5 per cent is calculated. There is a special exemption from the 4.5 per cent disbursement requirement for small charities – those which generally carry on charitable activities themselves and which, together with any related charities, have investment assets of less than \$250,000.

Transitional Provisions: For the first 10 years of the new system a transitional rule is provided in subparagraph 188(1)(b)(v) which will apply to those foundations that claimed a reserve under subsection 149.1(18) of the existing law. If the existing law were to continue, in its first taxation year under the new system the founda-

tion's disbursement quota for the year would include 90 per cent of the reserve claimed in the previous year. The transitional rule will require a portion of that reserve to be included in a charity's disbursement quota in each of the first 10 years of the new system. In the first year, it will be an amount not less than one-tenth of the amount by which 90 per cent of its reserve in the last year of the existing system exceeds the amount of gifts included in its disbursement quota under subparagraph (iii). The amount required to be included in its disbursement quota in the next nine years will depend on how much of the reserve has been included in previous years. (There is a further transitional rule, discussed in the commentary on subsection 188(6), designed to accommodate during the first year of the new system those gifts which are disbursed by a charity in the year of receipt. In subsequent years this problem is effectively dealt with through the carry-forward of unused excess qualified disbursements as defined in paragraph 188(1)(e).)

ITA
188(1)(c)

Paragraph 188(1)(c) defines "gift out of capital". A gift to a charity out of the capital of another charity is excluded both from the disbursement quota of the recipient charity and as a qualified disbursement of the donor charity. A gift out of the capital of a charity is one that is designated as such if, for the year in which the gift was made, the charity was not liable for the tax under subsection 188(3).

ITA
188(1)(d)

Paragraph 188(1)(d) defines the "qualified disbursements" of a charity. Where a charity has not made sufficient qualified disbursements in a year it will be liable to the special tax imposed under subsections (3) and (4). A charity's qualified disbursements at any time in a year is the total of

- disbursements made by it in the year on its charitable activities,
- gifts, other than gifts out of capital and gifts to related charities, made by it in the year to qualified donees,
- loans made by it in the course of its charitable activities or administration, and
- gifts made by it in the year to related charities to the extent that such gifts exceed the value of gifts that it has received in the year from related charities.

Any disbursements that are designated by a charity for the purpose of reducing its tax liability under subsection 188(4) are excluded from its qualified disbursements.

ITA
188(1)(e)

Paragraph 188(1)(e) defines the "unused excess qualified disbursements" of a charity. This excess is relevant in the calculation of the special Part V tax under subsections 188(3) and (4). The excess is determined in respect of a taxation year and as of a particular time thereafter. Essentially, it is the amount by which a charity's qualified disbursements in a year exceed its disbursement quota for that year. The unused excess for any year may be used by a charity to cover a shortfall in meeting its disbursement quota in any of the five years subsequent to that in which the excess arose. Thus, the unused excess qualified disbursements of a year reduce any shortfall of disbursements in a later year that would otherwise be subject to the Part V tax.

ITA
188(2)

Subsection 188(2) provides the method of determining the value of a charity's investment assets for the purpose of the 4.5 per cent rule under subparagraph 188(1)(b)(vi). The valuation allows a charity to smooth out irregular fluctuations in

the value of marketable securities and other assets. It permits assets to be valued over a period of time. This feature is particularly important to those charities which receive large endowments in a year. The averaging rules effectively reduce the 4.5 per cent disbursement requirement until investment funds have been held by a charity for two years.

A charity may take maximum advantage of this averaging provision by choosing to value its investment pool at the end of each quarter-year in the two-year period preceding the taxation year. It will value all such property on hand at the end of each quarter in accordance with the rules set out in the regulation and then determine the average of such quarterly values. Most properties, other than marketable securities, will not change in value more than once in the two-year period. In most circumstances, only marketable securities will have fluctuating values over the preceding two-year period and it is for these securities that the quarterly averaging provisions will be particularly helpful. A charity may choose to value its investment assets less frequently than at the end of each three-month period and thereby have fewer valuations to average. Indeed, a charity may not want to take advantage of averaging in which event it would choose a two-year period and thereby value its investment assets only at the beginning of each year. This would probably be the choice of a small charity in establishing that the value of its investment pool was less than \$250,000 and that the 4.5 per cent rule provided in subparagraph 188(1)(b)(vi) would not apply in determining its disbursement quota.

The choice of the number of valuation periods will affect the averaging over time. This may be particularly important to a new charity which has received a large endowment. Such a charity is treated as having existed at the end of each quarter in the preceding two-year period and for those quarters before it received its endowment the value of its investment pool would be zero. When these zero valuations are included in the aggregate to be averaged over the number of periods, the amount subject to a 4.5 per cent disbursement requirement will be reduced. This aspect of averaging moderates the sudden large increase that otherwise would occur in the disbursement quota of an existing charity which receives a large addition to its pool of investment capital.

There is a special rule for valuing gifts received by one charity out of the capital of a related charity. This rule avoids an undue reduction in the disbursement quota. Gifts out of capital, if received from a related charity at any time in the two-year period, are treated as though they had been received in the first of the periods used in the averaging calculation. A corresponding reduction is made in the value of property held by the related donor charity. The result is that the charity holding the property at the beginning of a year will be required to make the disbursements in respect of that property.

Once a charity has chosen the number of valuation periods in the preceding two years, the same number of periods will be required to be used subsequently unless the Minister of National Revenue has given his approval for the use of a different number of periods.

Subsection 188(3) imposes a tax of 15 per cent of the amount by which a charity's disbursement quota for a year exceeds its qualified disbursements for the year. The tax base is reduced by the amount of any "unused excess qualified disbursements" for the five preceding taxation years as defined in paragraph 188(1)(e). This tax, where it does apply, acts as a warning to a charity that it must

promptly make up the shortfall in its required disbursements or be subject to the special 100 per cent tax under subsection 188(4).

ITA
188(4)

Subsection 188(4) provides a special tax equal to 100 per cent of the portion of a charity's tax base, determined under subsection (3), that has not been matched by qualified disbursements made in the correction period and designated for this purpose or by unused excess qualified disbursements for years ending after that in respect of which the tax is payable and before the date of the assessment notice relating to the tax payable by the charity under subsection (3). Under subsection 188(8) liability for tax under this subsection arises 30 days after the end of the correction period.

ITA
188(5)

Subsection 188(5) is a saving provision providing for a refund where a charity incurs tax under subsection 188(3) as a result of an incorrect valuation used in determining its disbursement quota. Such refund will only be made if the incorrect valuation was not made knowingly or as a result of gross negligence and only to the extent that the charity has not become liable for the 100 per cent tax under subsection (4) for the year in respect of which the incorrect valuation was made.

ITA
188(6)

Subsection 188(6) provides a special transitional rule which has been referred to at the end of the explanatory note to paragraph 188(1)(b) – the disbursement quota. This rule provides that a charity's disbursement quota for its first taxation year commencing after 1983 will not exceed the amount of the property on hand at the beginning of the year that is not used in its charitable activities or administration.

ITA
188(7)

Subsection 188(7) provides that a charity liable for the special 15 per cent tax under subsection 188(3) shall file a return under Part V without notice or demand and estimate the amount of the tax payable. The return must be filed within the same four-month period as applies for the annual return of a charity under subsection 149.1(11) of the Act. Subsection 188(7) also requires the charity to pay the tax under subsection 188(3) on or before the date on which its return is required.

ITA
188(8)

Subsection 188(8) requires a charity liable for the special 15 per cent tax under subsection 188(3) to file without notice or demand a return and estimate therein the amount of the special 100 per cent tax under subsection 188(4) for which it is liable. This subsection also requires the charity to pay its tax. The return and payment of tax, if any, are due 30 days after the end of a charity's correction period as determined under paragraph 188(1)(a).

ITA
188(9)

Subsection 188(9) provides a charity with certain of the rights and responsibilities set out in Part I of the Act with respect to the filing of returns, assessments, interest, penalties, objections and appeals.

ITA
248(1)

The definition of "registered charity" has been transferred from subsection 110(8) to subsection 149.1(1) of the Act. The amendment to this definition in subsection 248(1) replaces the reference therein to subsection 110(8) with a reference to subsection 149.1(1).