

Lending a hand

Tax Guide for Charities



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2008 Edition

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Introduction

Charities are an integral part of our communities and all of us benefit when they fulfill their mandates.

Laws that apply to charities, including income and excise tax rules, are complex. Understanding how they apply can be difficult, and compliance can present challenges, especially to charities with tight budgets and those operated largely by volunteer staff and board members.

This publication provides information about operations and tax governance matters for management, directors, trustees and other officials of charities. It explains your charity's obligations and rights under Canada's *Income Tax Act* and *Excise Tax Act*, and describes how these laws may affect the organization's operations and decision-making.

Information in this publication reflects enacted and draft tax legislation to February 15, 2008.

We encourage you to seek professional tax advice on issues important to the health of your charity, especially those that:

- can affect its registered charity status;
- relate to those activities that enhance the delivery of charitable programs and the capacity of the charity to donate to other charities; and
- can increase transparency of the charity's activities and operations.

Please consult your PricewaterhouseCoopers LLP adviser or any of the individuals listed on page 33 for more information.

Registered charity versus other tax-exempt entities

For income tax purposes, there is a distinction between “registered charities” and other tax-exempt entities, such as non-profit organizations, agricultural organizations, boards of trade, chambers of commerce, low-cost housing corporations for the elderly, labour organizations and benevolent societies. None is subject to income tax under the *Income Tax Act*, but registered charities are permitted to issue tax receipts for donations they receive, while other tax-exempt entities cannot. Tax receipts entitle individual donors to a tax credit and corporate donors to a tax deduction. For an overview of the income tax incentives available to Canadian residents who make charitable donations, see PricewaterhouseCoopers’ *Charitable Giving Guide for Donors*.¹

Other non-charitable tax-exempt entities are discussed briefly on page 30.

Registered charities

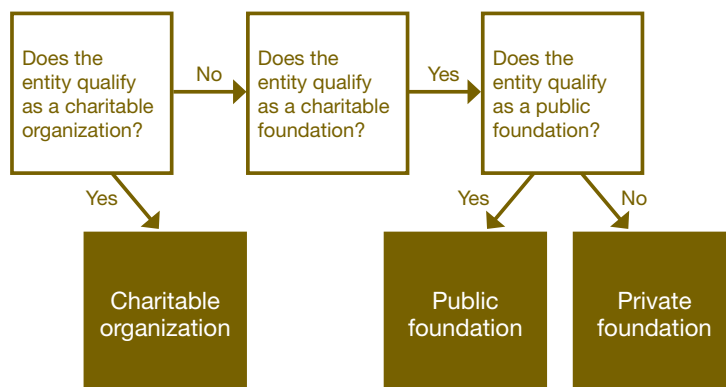
Registered charities are charitable entities that:

- are resident in Canada;
- were created or established in Canada; and
- have applied to and have been granted registered charity status by the Canada Revenue Agency.

A registered charity is assigned a designation as a charitable organization, a public foundation or a private foundation. The designation is intended to reflect the planned activities and purposes of the charitable entity. The designation determines the governance for the charitable entity under the *Income Tax Act*.

In 2006, Canada had 82,690 registered charities. Of these, approximately 89% were charitable organizations, 6% were public foundations and 5% were private foundations.²

The Canada Revenue Agency determines a charity’s designation based on the following decision tree:



Charitable organizations generally perform charitable activities and charitable foundations generally fund charitable organizations.

1. Publication to be available in 2008 at www.pwc.com/ca.
2. Statistics were provided by the Canada Revenue Agency.

Table 1 outlines the characteristics of charitable organizations, public foundations and private foundations. The terms “charitable activities” and “charitable purposes” are discussed in the following section.

Table 1: Designation of a registered charity

Requirements to be a charitable organization (e.g., hospital, university, art gallery, museum)		All of its resources are devoted to “charitable activities” that it carries on itself.
		No part of the income can be payable to, or available for, the personal benefit of any proprietor, member, shareholder, trustee, settlor or similar official.
		Must not be controlled by a person that contributed greater than 50% of the charity’s capital or by a group of persons that do not deal at arm’s-length with that person or with each other. ³
		More than 50% of the directors, trustees, officers, or similar officials deal at arm’s-length with: <ul style="list-style-type: none"> • each other and with all other similar officials; • a person that contributed greater than 50% of the charity’s capital, or a group of persons that do not deal at arm’s-length with that person or with each other; and • each member of a group of persons that do not deal with each other at arm’s-length, that have contributed more than 50% of the charity’s capital.³
Requirements to be a charitable foundation	Public foundation or private foundation	Corporation or trust constituted and operated exclusively for “charitable purposes.”
		No part of the income is payable to, or available for, the personal benefit of any director, trustee, officer or similar official.
		Is not a charitable organization.
	Public foundation (e.g., United Way)	Must not be controlled by a person that contributed greater than 50% of the charity’s capital or by a group of persons that do not deal at arm’s-length with that person or with each other. ³
		More than 50% of the directors, trustees, officers or similar officials deal at arm’s-length with: <ul style="list-style-type: none"> • each other and with all other similar officials; • a person that contributed greater than 50% of the charity’s capital, or a group of persons that do not deal at arm’s-length with that person or with each other; and • each member of a group of persons that do not deal with each other at arm’s-length, that have contributed more than 50% of the charity’s capital.³
		Private foundation

3. Applications for redesignation can be made retroactively for taxation years that begin after 1999, until 90 days after Bill C-10 receives royal assent. The Canada Revenue Agency began administering this draft amendment (Bill C-10) for registration and redesignation on July 11, 2007. A person for this purpose excludes Her Majesty in right of Canada (or of a province), a municipality, another charity that is not a private foundation, and any club, society or association.

What is considered charitable?

A charitable organization's resources are devoted to the "charitable activities" that it carries on. In contrast, a charitable foundation is operated exclusively for "charitable purposes." While there is a distinction between the passive purpose and active undertakings, both must be "charitable."

To be considered charitable for tax purposes, an organization's purpose must come within at least one of the following common-law classifications of charity:

- relief of poverty;
- advancement of education;
- advancement of religion; or
- other purposes beneficial to the community.

In addition to meeting one or more of the common-law classifications, a registered charity must be established and operated for the public benefit. To meet the public benefit test, among other things:

- the benefit should be tangible;
- the beneficiaries should be the public at large;
- the organization must not benefit private individuals; and
- the organization cannot:
 - exist for the benefit of its members;
 - restrict delivery of the benefits to a certain group or class of persons; or
 - charge fees for its services if the effect would be to unduly exclude members of the public.

Activities that are considered charitable

To be considered charitable, the following activities have specific rules that must be followed.

Disbursement of funds to qualified donees

Public and private foundations are considered to undertake charitable purposes if they disburse funds to qualified donees. There are no limits on the amount of its income that a public or private foundation can disburse to qualified donees.

Qualified donees include:

- registered charities (including Canadian universities and colleges);
- registered Canadian amateur athletic associations;
- certain non-profit housing corporations for the elderly;
- the United Nations and related agencies;
- Canadian or provincial governments, crown foundations and municipalities;
- foreign charities to which the government of Canada has made a gift in the donor's taxation year or in the 12 months preceding that year;
- prescribed foreign universities; and
- a municipal or public body performing a function of government in Canada.⁴

4. Draft amendment (Bill C-10) applicable to gifts made to these municipal or public bodies after May 8, 2000.

Unlike a charitable foundation, a charitable organization cannot disburse more than 50% of its income to qualified donees. However, there are no limits on the distribution of a charitable organization's income as gifts to associated charities (see **Disbursement quota** on page 15). As well, a transfer of a charitable organization's capital to a qualified donee is considered to be a devotion of the organization's resources to the charitable activities it is carrying out and is not considered to be paid out of the charitable organization's income. Therefore, the amount of a charitable organization's capital that can be disbursed to another qualified donee is unrestricted.

Carrying on a related business

As part of their charitable activities, public foundations and charitable organizations are permitted to carry on a business that is related to the registered charity's core activities. Private foundations are not permitted to run any type of business, whether related or not. Contravention can result in penalties and/or revocation of an entity's registered charity status (see **Tax penalties** on page 24 and **Revocation** on page 26).

In assessing a charity's planned and existing activities, it is necessary to determine if any of these activities constitutes "carrying on a business" and if so, whether it is a related business.

A business is generally defined as a commercial activity that generates revenues from goods and services and is undertaken with the intention to earn profit.

Soliciting of donations and selling donated goods are not considered business activities even though they are intended to generate a profit. As long as the elements of public benefit and altruism remain, charitable programs that involve fees are not considered business activities.

Fundraising activities are generally considered to be business activities but are not affected by the related-business provisions because they do not constitute "carrying on" of a business if the fundraising:

- has a clear beginning and end; and
- does not recur with regularity and frequency.

Earning income from investments is generally not considered to be carrying on a business if:

- income is derived primarily from ownership of the asset and does not depend on active trading;
- risk to the charity is generally limited to the purchase price of the asset; and
- earning the income is a passive activity that does not require the charity to take an active role.

Partnership earnings arising from an investment in another partnership are an exception to the rule that investment earnings are the result of passive activity. A charity that is a partner or limited partner in a partnership venture is considered by the Canada Revenue Agency to be carrying on a business even if the charity plays no active role in the partnership.⁵

The Canada Revenue Agency has stated that there are two kinds of related businesses:

- those run substantially (i.e., at least 90%) by volunteers; and
- those linked to a charity's purpose and subordinate to that purpose (as outlined in **Table 2**).

5. Canada Revenue Agency Policy Statement CPS-019, "What is a related business?"

Table 2: Related business of a charity not substantially run by volunteers⁶

<p>Linked to a charity's purpose (any condition must be met)</p>	<p>The related business is:</p> <ul style="list-style-type: none"> • a usual and necessary concomitant of charitable programs (e.g., a hospital parking lot, a museum gift shop); • an offshoot of a charitable program (e.g., the sale of recordings produced by a church choir); • a use of excess capacity (e.g., the rental of a school's parking lot on weekends); or • the sale of items that promote the charity or its objects (e.g., posters, pens, clothing).
<p>Subordinate to a charity's purpose (all four conditions must be met)</p>	<ul style="list-style-type: none"> • The business activity receives a minor portion of the charity's attention and resources relative to the charity's operations as a whole. • The business is integrated into the charity's operations, rather than acting as a self-contained unit. • The organization's charitable goals continue to dominate its decision-making. • The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter in its operations.

Amounts spent on carrying on a related business can include the payment of salaries to persons to perform actual charitable work (e.g., teaching, nursing) and the costs to purchase equipment that is directly used in charitable activities. Funds are not considered spent on a related business if they are spent on activities that support charitable objectives but do not directly accomplish them, such as management and administrative activities (e.g., investment counsel fees paid to manage an investment portfolio) and fundraising activities.

Disbursement of income to an associated registered charity

A gift of income to an associated charity is considered to be a charitable activity. To apply to become associated, both charities must complete and file Form T3011, *Registered Charities: Application for Designation as Associated Charities* with the Canada Revenue Agency. The Canada Revenue Agency will deem the charities to be associated if the charitable aims or activities of the charities are substantially the same. The Canada Revenue Agency has stated that it will consider an application to associate charities that undertake a joint project even if their charitable aims or activities are not substantially the same.⁷ This application is subject to public disclosure.

Carrying out direct charitable activities by a charitable foundation

The general purpose of charitable organizations is to perform direct charitable activities, while the general purpose of charitable foundations is to fund charitable activities. However, the *Income Tax Act* does not specifically restrict a charitable foundation (whether a public or private foundation) from undertaking direct charitable activities, if that foundation's constituting documents and bylaws (as supplied to the Canada

6. Canada Revenue Agency Policy Statement CPS-019, "What is a related business?"
7. Canada Revenue Agency RC4108 Guide, "Registered Charities and the *Income Tax Act*."

Revenue Agency in that entity's application for registered charity status) contemplate those activities. By undertaking any direct charitable activities, a charitable foundation becomes bound by the same limitations on activities as are imposed on charitable organizations.

Limitations on activities

Political activities

A registered charity's resources can be used for political activities if:

- substantially all of the resources are devoted to a non-political charitable purpose or activity;
- the political activities are ancillary and incidental to the charitable activity or purpose; and
- those activities do not include the direct or indirect support of, or opposition to, any political party or candidate for public office.

The Canada Revenue Agency interprets "ancillary" to mean that no more than 10% of the charity's resources are used to fund non-partisan political activities.⁸ The charity's resources include all of its assets, financial or otherwise, as well as its employees and volunteers. The charity's registration could be revoked if it exceeds the 10% limit.

Political activities do not include public awareness campaigns or communications with an elected representative or a public official. Public awareness campaigns, through which a charity seeks to foster public awareness about its work or an issue related to that work, are considered charitable activities if they:

- are connected and subordinate to the charity's purpose;

- are based on a well-reasoned position; and
- do not use primarily emotive material.

Communication with an elected representative or public official is also considered to be charitable if the activity is subordinate to the charity's purpose and the representations made:

- relate to an issue that is connected to the charity's purpose;
- are well reasoned; and
- do not contain information that the charity knows or ought to know is false, inaccurate or misleading.

The Canada Revenue Agency recognizes that the "substantially all" rule could hurt smaller charities that might spend funds on political activities that exceed the statutory limits. Administratively, the Canada Revenue Agency considers that smaller charities are not using their resources excessively on political activities as long as their expenditures on political activities fall within the administrative guidelines outlined in **Table 3**.⁹

Table 3: Administrative guidelines for political spending by small charities

		% of resources that can be devoted to political activities in the current year
Annual income in the previous year	Less than \$50,000	20%
	From \$50,000 to \$100,000	15%
	From \$100,000 to \$200,000	12%

8. RC 4108 "Registered Charities and the *Income Tax Act*."

9. Canada Revenue Agency Policy Statement CPS-022, "Political Activities."

Charitable activities outside of Canada

A charity's registration can be revoked if it makes a disbursement by way of a gift other than to a qualified donee or in the course of charitable activities carried on by it.¹⁰ This rule prevents a registered charity from using its resources to fund any foreign charitable organization (other than a qualified donee). A charity can operate outside Canada if its constituting documents contemplate that kind of activity and it carries out its charitable programs itself, using its staff and other resources. The Canada Revenue Agency recognizes that it may not be practical for a charity to meet the charitable activities test by operating abroad using its own employees or volunteers. A charity can work internationally with or through other organizations if it retains direction and control over the use of its resources by:

- appointing an agent to act as the charity's representative;
- contracting with an organization or an individual;
- pooling resources through a joint venture; or
- forming a co-operative partnership in which the charity takes responsibility for a particular aspect of the project.¹¹

Incurring debt

Public and private foundations are not permitted to incur debt, except:

- for current operating expenses;
- in connection with the purchase and sale of investments; or
- in the course of administering charitable activities.

Incurring other debt can cause the charitable foundation's charitable status to be revoked.

Acquisition of control of a corporation

Although public foundations are generally not permitted to acquire control of a corporation, it is permissible for a public foundation to be given shares of a corporation even if this results in the foundation's acquiring control. The public foundation cannot purchase more than 5% of the issued shares of any class of shares of the corporation. Certain corporate reorganizations, such as one causing an exchange of the donated shares for new shares, can result in the public foundation's being considered to have acquired control of the corporation.

Control is defined as ownership of more than 50% of the votes by the charitable foundation or persons not dealing at arm's-length with the foundation.

By acquiring control of a corporation, a charitable foundation can become subject to monetary penalties (see **Tax penalties** on page 24) or have its registration revoked (revocation applies to public foundations only).

Private foundations are subject to an excess corporate holdings regime (see **Excess corporate holdings regime for private foundations** on page 13)¹² introduced in 2007.

Provincial legislation that governs charities can also impose restrictions on corporate investment holdings by charities.

10. Draft amendment (Bill C-10) applicable to gifts made after December 20, 2002.

11. RC4106(E) "Registered Charities: Operating Outside Canada."

12. For an overview of the excess corporate holdings regime for private foundations, see PricewaterhouseCoopers' *Tax Memo* "New Tax Era for Private Foundations" at www.pwc.com/ca/privatefoundations.

Registration

An organization should determine if registration as a registered charity is beneficial, given its anticipated funding sources. Under certain circumstances, such as if an organization anticipates receiving donations for which donation tax receipts are not required by the donor (e.g., government funding, foreign-source funding), it may prefer not to register as a charity and instead operate as another kind of tax-exempt entity.

Federal registration

In 2006, the Canada Revenue Agency received 3,538 new applications for registration, registered or re-registered 2,459 charities, denied 254 applications and sent 825 letters to applicants advising them of its view that, based on specific concerns, they would not qualify for registration.

The registration process is involved and time-consuming. The more detail and effort put into the registration application and the constituting documents of the registering entity, the more likely it will be accepted within a reasonable time, provided, of course, that its charitable intent, purpose and planned activities are considered charitable in law.

The registration process includes the completion of Form T2050, *Application to Register a Charity Under the Income Tax Act*. The application, along with the attachments listed in **Table 4**, must be completed and submitted to the Charities Directorate of the Canada Revenue Agency.

If the application is approved, the charity will receive a *Notification of Registration* from the Canada Revenue Agency. This notification provides the charity with a business number (BN) that formally acknowledges that the entity is a registered charity. The business number is a nine-digit number with an alpha suffix “RR.” It is different from that issued to taxpayers, such as corporations that have corporate income tax accounts or employers that have payroll tax accounts with the Canada Revenue Agency.

Upon registration, the charity will be designated as a charitable organization, a public foundation or a private foundation, depending on the details provided in the application. A charity’s designation notice may be disclosed to the public by the Canada Revenue Agency. Any false statements made by a charity to obtain registration can result in the revocation of its registration (see **Revocation** on page 26).

Table 4: Attachments to Form T2050, *Application to Register a Charity Under the Income Tax Act*

<p>Official copy of the governing documents</p>	<p>Governing documents include letters patent, articles of incorporation, trust deeds or constitutions that legally establish the charity and that identify the objects or purposes for which it is established, as well as provide information on the organization's corporate structure and internal procedures.</p> <p>Organizations seeking designation as a charitable foundation must be constituted as a corporation or a trust. Charitable organizations seeking designation can be constituted as a corporation, a trust or an unincorporated entity.</p>
<p>Statement of activities</p>	<p>The statement of activities should be detailed. It should not simply restate the purposes for which the organization was established. The following questions should be addressed:</p> <ul style="list-style-type: none"> • What exactly is the organization doing or planning to do? • How is it trying to implement its announced purposes? • Who are its beneficiaries (if any) and how are they selected? • Will it be doing the work or will it be contracting others to deliver the required services? • How many employees or volunteers does it have? • Where will it be active? • What fees, if any, will it charge its clientele? • How does it intend to raise funds?
<p>Financial statements</p>	<p>Financial statements, which include a statement of income and expenditures and a statement of assets and liabilities, should be detailed. Pro-forma financial statements are also acceptable if the organization has not been in existence for a full year.</p>
<p>A list of the directors, trustees or officials</p>	<p>A list of directors, trustees or other similar officials that comprise the elected or appointed governing body is required. Full names, addresses and occupations should be provided.</p>

Registration in Quebec

To register in Quebec, a registered charity must submit the following within 30 days following confirmation of its federal registration with the Canada Revenue Agency:

- Form TP-985.5-V, *Application for Registration as a Charity*;
- a copy of the registration notice issued by the Canada Revenue Agency; and

- a copy of Form T2050, *Application to Register a Charity Under the Income Tax Act*, as well as the attachments included with the federal application (see **Table 4**).

Tax Governance

Receipting privileges

A registered charity can issue official donation tax receipts for donations it receives. Tax rules govern what information should be disclosed on the tax receipts, as well as penalties, including revocation of registration, for issuing tax receipts that do not comply (see **Revocation** on page 26). Official donation tax receipts should contain:

- a statement that it is an official receipt for income tax purposes;
- the name and Canadian address of the charity;
- the registration number assigned to the charity;
- the serial number of the receipt;
- the place or locality of issuance of the receipt;
- the donor's name (i.e., first name, initial and surname if the donor is an individual) and address;
- for a cash donation, the full date or the year in which the donation was received;
- for a non-cash donation:
 - the date on which the donation was received;
 - description of the property; and
 - name and address of the appraiser of the property (if applicable);
- the date on which the receipt was issued if different than the date on which the donation was made;
- the contribution amount of:
 - the cash donation; or
 - the fair market value of the property at the time the gift was made;
- a description and the amount of the advantage, if any;¹³
- the eligible amount of the gift;¹³

- the signature of a responsible individual who has been authorized by the charity to acknowledge donations; and
- the name and current website of the Canada Revenue Agency.

Split receipting¹⁴

In 2002, the Department of Finance introduced guidelines on what constitutes a “gift” for tax receipting, and tax credit or deduction purposes. The guidelines result from various court cases that argued that the common-law meaning of a “gift” was not always appropriate when applied to partial gifts if the donor or a person related to the donor receives an advantage. These rules are intended to legislate that the tax benefit to a donor should reflect the net economic effect on the donor of the gift or contribution (before considering the income tax benefit).

The key aspects of the draft guidelines are as follows:

- an advantage to the donor or person related to the donor does not disqualify the transfer from being a gift if either the amount of the advantage is 80% or less of the fair market value of the transferred property or the donor can establish that there was a clear intention to make a gift; and
- the tax-receiptable gift amount (the “eligible amount of the gift”) is the fair market value of the contribution less the amount of the advantage received by the donor or a person related to the donor.

The concept of an advantage does not apply to inter-charity gifts. Advantage is generally defined as the total of the fair value at the time of the gift, of any property, services, compensation or other benefits, including limited-recourse debt (see **Anti-avoidance provisions** on page 12), to which the donor or person related to the donor is entitled.

13. Draft amendment applicable to gifts made after December 20, 2002.

14. The section on split-receipting describes draft amendments (Bill C-10) that generally apply to gifts made after December 20, 2002.

Example¹⁵

Ms. Cooper paid \$300 to participate in a golf tournament held by a charity. The \$30 cart rental and the \$50 green fee were included in the \$300 participation fee. She received \$20 worth of golf balls and \$30 worth of food and beverages. Door prizes that Ms. Cooper had a chance of winning were worth approximately \$40 per each person attending the tournament.

What is the amount of the gift that can be tax-receipted (i.e., the eligible amount of the gift)?

Participation fee	\$300
Less: Cart rental	\$30
Green fee	\$50
Golf balls	\$20
Food and beverage	\$30
Door prizes	<u>\$40</u>
Advantage	<u>\$170</u>
Eligible amount of the gift	<u>\$130</u>

Anti-avoidance provisions¹⁶

The Department of Finance has drafted new rules intended to curb various tax shelters, including valuation-based shelters and leveraged donations.

Valuation-based shelters include “art flips” and other plans involving “buy low, donate high” schemes. The draft rules are intended to curtail valuation shelters by limiting the eligible amount of the gift to the cost that the donor paid for the property if the property is donated within three years of acquisition by the donor (or within ten years of acquisition if one of the main purposes of the acquisition was to donate the property), or is otherwise

acquired under a gifting arrangement that is a tax shelter. The anti-avoidance provisions do not apply to the following gifts of property (known as “excepted gifts”):

- inventory;
- an ecological gift;
- real property situated in Canada;
- certain publicly listed securities including:
 - shares, debt obligations and rights, if listed on a designated stock exchange;
 - shares in a mutual fund corporation, units in a mutual fund trust and segregated fund units; and
 - prescribed debt obligations;
- cultural property, the value of which is certified by the Canadian Cultural Property Export Review Board;
- a share of a corporation that was issued to the donor if, before the gift, the corporation was controlled by the donor, a person related to the donor or a group of persons each of which was related to the donor; or
- property obtained by an individual or corporation on a tax-deferred rollover basis.

Leveraged donations involve a donor’s obtaining a loan to make a donation to a registered charity. The donor then invests in a fund that generates returns that allow the donor to repay the loan. The draft rules stipulate that the amount of the eligible gift is reduced by the amount of the loan.

A donation will have no eligible gift value if, before the charity issues the donation tax receipt, the donor does not inform the charity of any information that is necessary for the charity to determine the eligible amount (such as advantage information) or to apply the anti-avoidance provisions outlined above. The charity needs this information to prepare the donation tax receipt correctly.

15. Adapted from Income Tax Technical News 26.

16. The anti-avoidance section outlines draft amendments (Bill C-10) that apply to gifts at different dates depending on the applicable *Income Tax Act* section.

Suspension of receipting privileges

A registered charity's receipting privileges may be suspended by the Canada Revenue Agency if certain penalties are assessed (see **Tax penalties** on page 24). Receipting privileges can be suspended for a year starting on the seventh day after the suspension assessment has been mailed. Gifts made to a charity during its suspension will not be considered gifts to a qualified donee, and donors will not be entitled to a tax credit or a tax deduction. During the suspension period, before a charity accepts a gift it must inform all potential donors of the suspension notice and of the effect of the suspension on the potential gift. A charity can apply to have the suspension postponed and can object to the suspension. The Canada Revenue Agency can disclose suspension letters to the public.

Excess corporate holdings regime for private foundations¹⁷

Bill C-28, known as the *Budget and Economic Statement Implementation Act*, received royal assent on December 14, 2007. This new legislation enhances Canada's tax incentives for individuals, trusts and corporations that donate publicly listed securities to private foundations after March 18, 2007, by extending the capital gains exemption to these gifts. However, to address the federal government's concerns regarding potential self-dealing opportunities for a private foundation and persons not dealing at arm's-length with the foundation, the legislation restricts a private foundation's significant holdings in both public and private corporations.

This new regime can:

- limit the private foundation's shareholdings (taking into account the holdings of persons not dealing at arm's-length with the private foundation);

- require the private foundation's shareholdings of all classes of any corporation to be monitored;
- significantly increase the annual information return reporting requirements for the private foundation of its shareholdings in a corporation when the foundation holds more than 2% of the outstanding shares of any class of shares of the corporation;
- require the private foundation to report information regarding the shareholdings of persons not dealing at arm's-length with the private foundation; and
- require shares to be divested.

Income of a registered charity

The income of a registered charity is relevant when:

- assessing whether any part of the charity's income is payable or otherwise available to personally benefit a person connected with the charity; and
- determining if a charitable organization has expended more than 50% of its income on gifts in a particular year to qualified donees.

Income is computed as it would be for other Canadian-resident taxpayers, taking into account certain adjustments, addressed below.

A charity's income includes all gifts received in the year, including gifts from other charities, other than:

- a specified gift;
- a gift of an enduring property;
- a gift received from another registered charity that was not from the other charity's income (i.e., a gift of capital); or

17. For an overview of the excess corporate holdings regime for private foundations, see PricewaterhouseCoopers' *Tax Memo "New Tax Era for Private Foundations"* at www.pwc.com/ca/privatefoundations.

- a gift received from a non-charity for which the individual or corporate donor was not entitled to a tax credit or tax deduction, or from an entity that is not subject to Part I income tax in the year in which the gift was made.

A specified gift is a gift that is made through an agreement by one registered charity with another and is identified as “specified” in the charity’s annual information return. It is a way in which a charity can make a gift to another charity without affecting either charity’s disbursement quota (see **Disbursement quota** on page 15). However, if the main purpose of the gift is to delay the expenditure on charitable activities, both charities’ designations could be revoked.

Enduring property

Enduring property includes property of a charity that has been received:

- by way of bequest or inheritance;
- by a charitable organization from another charity that is subject to a trust or direction that the donated property is to be held by the charitable organization for a period of not more than five years and must be spent entirely over the period on:
 - acquisition of tangible capital property to be used in charitable activities or administration; and/or
 - a program of charitable activities of the charitable organization that cannot be completed before the end of the fiscal year following the gift;

- by a charity that is subject to a trust or direction that the donated property is to be held by the charity for at least 10 years and through the trust or the direction the charity is permitted to:
 - transfer the property to another charity subject to the same terms as the original gift; and/or
 - expend a certain amount of the gift before the end of the period to meet the 3.5% disbursement quota requirement (see **Disbursement quota** on page 15); or
- by a charity from another charity if the original charity received the gift by way of:
 - bequest or inheritance; or
 - a 10-year gift.

Disbursement quota

A main indicator of whether a registered charity has fulfilled its charitable mandate under the *Income Tax Act* is if it has met its disbursement quota (i.e., the requirement to expend a minimum amount of its funds on direct charitable activities and gifts to qualified donees).

A charity's disbursement quota is a complex computation. The amount is generally based on the previous year's activities. **Box 1** outlines the details of the calculation of the disbursement quota. For charitable organizations that were registered before March 23, 2004, the 3.5% disbursement requirement on assets that are not used directly in charitable activities or its administration will apply for taxation years that begin after December 31, 2008.

Disbursement excess

If, for a particular taxation year, a charity expends more on its charitable activities and/or gifts to qualified donees than its disbursement quota requirement, a disbursement excess is created. The disbursement excess can be used by the charity to reduce or eliminate a disbursement shortfall of the preceding taxation year or to help meet its disbursement requirements for any of the following five taxation years.

Disbursement shortfall

A disbursement shortfall occurs if a charity spends less than its disbursement quota for that year on charitable activities or on gifts to qualified donees. This shortfall can be reduced by using previous years' disbursement excesses (if any). Frequent shortfalls by the charity can lead to revocation of its registration (see **Revocation** on page 26).

Box 1: Disbursement quota

In general terms, a charity must expend a minimum amount of its assets each year equal to the total of:

- a percentage (80% for charitable organizations and public foundations or 100% for private foundations) of the preceding year's non-enduring property (see **Income of a registered charity** on page 13) and non-specified gift donations (see **Income of a registered charity**) from other registered charities;
- 80% of the preceding year's tax-receipted non-enduring property eligible donations (see **Split receipting** on page 11) from individuals, trusts and corporations;
- 80% of the current year's enduring property expended (excluding enduring property transferred by another charity as a specified gift or as a bequest or inheritance before 1994);
- 100% of the fair market value of enduring property (excluding a specified gift) transferred as a gift to a qualified donee (see **Activities that are considered charitable** on page 4) by the charity during the current year;

less a capital gains reduction claim (see **Capital gains pool** on page 16).

The charity must also expend an additional amount roughly equal to:

- 3.5% of the value of its property owned that is not used in charitable activities or administration if this value exceeds \$25,000;
- less 3.5% of the sum of:
 - 100% of enduring property transferred to qualified donees in the current year;
 - 100% of the previous year's non-enduring property gifts from non-charities;
 - 100% of enduring property expended in the current year; and
 - 100% of the previous year's non-enduring property and non-specified gift donations from other charities.

Capital gains pool

The registered charity may elect to reduce its disbursement quota by an amount called a capital gains reduction, which arises from a notional balance called the capital gains pool. The capital gains pool is:

- the sum of all capital gains realized on the sale or disposition of enduring properties after March 22, 2004, that have been declared by the charity in its annual information return for the taxation year in which the sale or disposition occurred; less
- the aggregate of all capital gain reductions previously claimed.

For public and private foundations, a disbursement quota reduction may be claimed in a particular year, subject to certain limitations. For charitable organizations registered before March 23, 2004, a disbursement quota reduction may be claimed for taxation years beginning after December 31, 2008.

Accumulation of property

A registered charity may request permission from the Minister of National Revenue to accumulate property for a specific purpose and over a specified period without the accumulation affecting the charity's disbursement quota. One situation would be when a charity fundraises for a capital project, such as a new building, over a number of years before construction begins.

The charity must receive, from the Canada Revenue Agency, written approval of the terms, conditions, and period for the accumulation of the property. The property accumulated and the income earned on the accumulated property is deemed to be spent on charitable activities in the taxation year in which it is accumulated or earned, rather than in the taxation year(s) the funds are actually spent. As a result, the charity is not entitled to a further

qualifying charitable expenditure when the accumulated funds are subsequently spent.

The accumulated amount and the income earned on it will be deemed to be receipted income of the charity of a particular taxation year if the property is not used:

- at the end of the agreed period; or
- for the purpose for which it was accumulated.

In that situation, 80% of this accumulated property must be expended in the year following the taxation year in which it is deemed to be receipted income.

Reduction in disbursement quota

Under extraordinary circumstances, a registered charity can apply to the Minister of National Revenue to have its disbursement quota reduced. This requires completing and filing Form T2094, *Registered Charities: Application to Reduce Disbursement Quota*. One circumstance that could warrant the reduction is the failure of a charitable foundation's investment portfolio to realize an investment yield greater than the minimum 3.5% disbursement requirement on investment assets that are owned by the charity.

Any disbursement excesses from the previous five taxation years must be used before a reduction in the disbursement quota will be permitted.

Public disclosure of registered charity information

The Canada Revenue Agency communicates or makes certain information available to the public and can also provide information regarding a registered charity to another person (**Table 5**).

Table 5: Public disclosure of charity information

<p>Information that is communicated or made available to the public</p>	<p>All of:</p> <ul style="list-style-type: none"> • The information contained in a public information return, which excludes all personal information other than the name of the charity’s directors or trustees (see Income tax filing requirements on page 18). • If at the end of a taxation year a private foundation holds more than 2% of a class of shares of the capital stock of a corporation;¹⁸ <ul style="list-style-type: none"> – the name of the corporation; and – the holdings of the class of shares of the corporation that are held by the private foundation and by a person that does not deal at arm’s-length with the private foundation.
<p>Information that can be provided to the public</p>	<p>All of:</p> <ul style="list-style-type: none"> • A list of all registered or previously registered charities, including the charity’s name and address, registration number and date of registration, and the effective date of any revocation, annulment or termination of its registration. • A copy of the charity’s governing documents, including its statement of purpose. • Any information provided in prescribed form to the Canada Revenue Agency by the charity on applying for registration under the <i>Income Tax Act</i>. • The names of persons who at any time were the charity’s directors, and the periods during which they were directors. • A copy of the notification of the charity’s registration, including any conditions and warnings. • A copy of part of, or the entire, letter sent by, or on behalf of, the Canada Revenue Agency to the charity relating to the grounds for the revocation or annulment (if the charity’s registration of the charity has been revoked). • Financial statements required to be filed with an information return. • A copy of part of, or the entire, letter or notice sent by the Canada Revenue Agency to the charity relating to a suspension or an assessment of tax or penalty under the <i>Income Tax Act</i> (other than the amount of revocation tax). • An application by the charity, and information filed in support of the application, for a designation, determination or decision by the Canada Revenue Agency regarding an application to deem an amount as an expenditure on charitable activities carried on by the charity;¹⁹ designation of associated charities, accumulation of property (if the property is deemed to have been expended on charitable activities) and designation of a private foundation as a public foundation.

18. For an overview of the excess corporate holdings regime for private foundations, see PricewaterhouseCoopers’ *Tax Memo* “New Tax Era for Private Foundations” at www.pwc.com/ca/privatefoundations.

19. Draft amendment (Bill C-10) applicable upon royal assent.

Books and records

A registered charity must maintain its books and records for a minimum period as noted in **Table 6**. The Minister of National Revenue has discretion to provide written permission to a charity to destroy its books and records earlier than those times.

Table 6: Periods for maintenance of books and retention of records

		Minimum retention	
Books and records	Duplicates of receipts for donations (other than 10-year gifts)	Two years from the end of the calendar year in which the donation was made	
	Books and records, accounts and vouchers containing the summaries of the year-to-year transactions of the charity and any special contracts or agreements that help to understand entries made in the general ledger	Six years from the end of the fiscal period to which they relate	or
	Records of any donations received that are subject to the direction by the donor that the property given be held by the charity for a period of not less than 10 years	Two years after revocation of registration or dissolution of the charity	
	Minutes of meetings of the executive		
	Minutes of meetings of the members		
All governing documents and bylaws			

Income tax filing requirements

Registered charities

A registered charity must file an annual information return with the Canada Revenue Agency within six months after the end of its taxation year. An annual information return includes:

- Form T3010A, *Registered Charity Information Return*;
- Form TF725, *Registered Charity Basic Information Sheet*;

- the list of directors/trustees or like officials, with all the required information, Form T1235, *Directors/Trustees Worksheet*;
- the list of gifts to qualified donees, with all the required information (if applicable), Form T1236, *Qualified Donees Worksheet*; and
- a copy of the charity's financial statements.

The information contained in the public portion of the information return can be disclosed to the public. The remaining information provided is solely for the Canada Revenue Agency's use. (See **Public disclosure of registered charity information** on page 17.)

Failure to file an annual return can result in a \$500 penalty as well as a revocation of registration (see **Sanctions for non-compliance** on page 24). In 2006, the Canada Revenue Agency revoked 972 registered charities for failure to file their annual charity information returns in the six-month period after their fiscal year ends. Information returns may be required when registration is revoked.

If the annual information return has not been filed within five months of the end of the charity's fiscal period, the Canada Revenue Agency sends a computer-generated reminder Form TX11D, *Reminder to Registered Charities to File Return*. The Canada Revenue Agency has subsequent follow-up procedures if it does not receive the annual information form, including:

- sending Form T2051A, *Notice of Intention to Revoke a Charity's Registration* (the charity has 90 days from the date the form is issued to file an objection if it believes it has met the filing requirements);
- contacting representatives of the charity by telephone to remind them to file the annual return; and/or
- beginning revocation proceedings by sending the charity Form T2051B, *Notice of Revocation of a Charity's Registration* (this form includes the effective date of the revocation and includes Form T2046, *Tax Return Where Registration of a Charity is Revoked*).

Non-profit organizations

A non-profit organization is required to file Form T1044, *Non-Profit Organization (NPO) Information Return* annually if it meets any of the following conditions:

- has assets exceeding \$200,000 for the preceding taxation year;
- earns dividend, interest, rent or royalty income exceeding \$10,000 in the current taxation year; or
- was required to file Form T1044, *Non-Profit Organization Information Return* for any previous taxation year.

All non-profit organizations that are corporations are required to file federal corporate tax returns annually, regardless of their total assets or revenues.

Other filing requirements

In certain circumstances, registered charities and other tax-exempt organizations are required to file more than an annual information return. **Table 7** outlines the main tax filing requirements for non-profit organizations, charitable organizations, public foundations and private foundations. In addition, charities and other tax-exempt organizations that are incorporated must meet corporate governance rules for their jurisdiction of incorporation.

Registered charities and other tax-exempt organizations may also have reporting and filing obligations related to, for example, payroll reporting, payments to non-resident persons, Goods and Services Tax or Harmonized Sales Tax and provincial sales tax.

Table 7: Tax governance deliverables and deadlines

	Non-profit organization		Charity							
	Corporation	Not incorporated	Charitable organization			Public foundation		Private foundation		
			Corporation	Trust	Not incorporated	Corporation	Trust	Corporation	Trust	
Federal	Annual information return (T1044)	Possibly (six months after year end)		N/A						
	Annual information return (T3010A)	N/A		Yes (six months after year end)						
	Income tax return	Corporate (T2)	Yes (six months after year end)	No	N/A		No	N/A	No	N/A
		Trust (T3)	Possibly (90 days after year end)	N/A	No	N/A		N/A	No	N/A
	Remuneration (T4 slips and summaries)	Yes (last day of February)								
	Various payments and benefits ²⁰ (T4A slips and summaries)									
	Non-arm's length transactions with non-residents ²¹ (T106)	Yes ²²								
	Foreign affiliate reporting (T1134 A and T1134 B)	No								
	Foreign income verification statement (T1135)									
	Ontario	Corporate income tax return (CT23)					N/A		N/A	
Alberta	Corporate income tax return (AT1)					N/A		N/A		
Quebec	Income tax return	Trust (TP-646)	Possibly (90 days after year end)	N/A	N/A	No	N/A	N/A	No	N/A
		Corporate (CO-17-V)	Yes (six months after year end)	No	N/A		No	N/A	No	N/A
	Information return	Charity (TP-985.22-V)	Yes (six months after year end)							
NPO (TP-997.1-V)		Possibly (six months after year end)		N/A						

20. Includes scholarship, fellowship, bursary or other benefits and payments.

21. Required if amounts during the year exceed \$1,000,000 and relate to "reportable transactions."

22. Due date is the same as the filing due date for the income tax return or the annual information return (if no income tax return is required).

Goods and Services Tax/Harmonized Sales Tax

Registered charities and non-profit organizations must meet the requirements of either the Goods and Services Tax (GST), or the Harmonized Sales Tax (HST) if they are located in Nova Scotia, New Brunswick or Newfoundland and Labrador (the harmonized provinces). The GST and HST are consumption taxes that are charged on taxable supplies produced through commercial activities in Canada. Outside of the harmonized provinces GST applies. In the harmonized provinces HST applies. The GST/HST rules relating to charities are among the most complex part of the GST/HST legislation.

Classification for GST/HST purposes

To determine if supplies are subject to GST or HST, registered charities are subdivided into public institutions and charities. Registered charities classified as public institutions are taxed for GST/HST purposes in a similar manner to charities, with additional exemptions available to public institutions in a few key areas. **Table 8** outlines the income tax and GST/HST classification differences, as well as the effect of the GST/HST classification on the taxation of supplies.

Zero-rated, exempt and taxable supplies

Zero-rated supplies are taxable at a rate of 0%. Although no GST/HST is charged on the supply of zero-rated goods and services, input tax credits (ITCs) typically can be claimed for GST/HST that a registrant pays or owes on purchases and expenses incurred to provide the zero-rated goods and services. Examples of zero-rated goods and services include:²³

- basic groceries;
- certain goods when exported outside Canada;
- prescription drugs; and
- certain medical devices.

Examples of exempt supplies of charities and public institutions include:²³

- specified fund-raising activities;
- direct cost exemption (i.e., when goods and services are supplied for consideration less than their direct cost);
- gambling events;
- certain recreational programs;

Table 8: Income tax and GST/HST classification differences

		GST/HST classification	Taxation of supplies
Income tax classification	Non-profit organization	Non-profit organization	Most supplies are taxable, except for those listed as zero-rated or exempt
	Registered charity that is a school authority, public college, university, hospital authority or local authority determined to be a municipality	Public institution	Most supplies are exempt, except for those listed as taxable
	Other registered charity	Charity	

23. RC 4082 "GST/HST Information for Charities."

- free supplies;
- certain memberships;
- certain admissions; and
- food, beverages and short-term accommodation to relieve poverty, suffering or distress of individuals.

Most supplies of goods and services made by charities are exempt from GST/HST (see **Table 8**). **Table 9** lists some examples of exempt and taxable goods and services for a registered charity that is not a public institution.

Table 9: Exempt and taxable goods and services for a non-public institution registered charity

Exempt ²⁴	Taxable ²⁴
<ul style="list-style-type: none"> • Most services • Supplies of used and donated goods • Short-term residential accommodation (less than one month of occupancy) • Meals-on-wheels programs • Parking space rentals • Facility rentals • Catering services for private functions 	<ul style="list-style-type: none"> • Supplies of certain personal property • New goods that the charity bought, manufactured, or produced to resell • Certain sales and leases of real property • Admission to a place of amusement, such as a museum, recreational complex or theatre, if any admission charged is more than \$1 • Memberships that entitle members to benefits, such as free or discounted admission to a place of amusement (e.g., museum, recreational complex or theatre) • Restaurant operations • Professional theatre subscriptions • Lottery tickets if the charity sells them for a provincial lottery corporation • Services of performing artists if the charity provides the services to another organization that is selling taxable admissions to the performance

24. RC 4082 "GST/HST Information for Charities."

General GST/HST rules

A charity, public institution or non-profit organization (collectively “public service bodies”) has to register for GST/HST when it makes taxable supplies and is not a small supplier. A small supplier includes a public service body with annual revenues from worldwide taxable supplies equal to or less than \$50,000. A charity or public institution is also considered a small supplier if its gross revenue in either of the two preceding fiscal years is \$250,000 or less.

A small supplier has the option of registering, but is not required to do so. Once registered, a public service body must charge GST on taxable supplies, can claim ITCs to recover GST paid in relation to its taxable supplies and must file GST returns. **Table 10** outlines the rules for public service bodies in different scenarios.

Additional information to provide to the Canada Revenue Agency

A change in a registered charity’s taxation year end, the reason for the change and the effective date of the change must be disclosed in writing to the Canada Revenue Agency, Charities Directorate before the year end is changed. If the change results in a period longer than 12 months, the charity may have to file two annual returns for the period.

A charity that changes its name must submit the following documentation to the Canada Revenue Agency, Charities Directorate:

- if an incorporated entity, its supplementary letters patent or certificate of amendment;
- if an unincorporated entity, a copy of the resolution or written agreement; or
- if a trust, a deed of amendment.

Table 10: GST/HST rules applicable to public service bodies

	Only exempt supplies	Taxable supplies		
		Registered for GST	Small supplier Not registered for GST	Other
Can register for GST?	No	Optional		
Charge GST on taxable supplies/goods?	N/A			
Claim ITC to recover GST paid?	No		No	
Have to file GST returns?		Yes		
Eligible for public service body rebate?				

The Charities Directorate of the Canada Revenue Agency should be consulted before a charity undertakes activities and/or develops purposes different from those originally submitted with its registration application to the Canada Revenue Agency, because the charity's registration or designation could be affected.

Other situations may affect a charity's designation and should be communicated to the Canada Revenue Agency. These include when:

- the charity receives a large donation that results in more than half of its funding coming from a single source;
- the charity changes from an operational charity to one that uses more than half of its income to fund other charities; or
- half or more of its directors or trustees cease to be at arm's-length with each other.

Auditing of charities

The Canada Revenue Agency regularly audits charities to ensure they are complying with the *Income Tax Act*. In 2006, the Canada Revenue Agency completed the audit of 989 charities as a result of public complaints or random selection, or to review specific legal obligations under the *Income Tax Act* or confirm that assets have been distributed after revocation, or based on annual information returns.

Sanctions for non-compliance

Until the introduction of the sanctions for non-compliance applicable to taxation years beginning after March 22, 2004, the only penalty available to the Canada Revenue Agency to enforce the *Income Tax Act* was to revoke the charity's

registration. The *Income Tax Act* was amended to introduce less severe sanctions, because revocation was viewed as too severe for many infractions. Administratively, the Canada Revenue Agency uses education and compliance agreements.²⁵ By statute, the Canada Revenue Agency can impose tax penalties and ultimately revocation to enforce compliance.

Education

Education includes the Canada Revenue Agency's:

- providing an "education letter" upon completion of the audit of a registered charity that explains the rules to the charity; or
- offering advice during the course of an audit.

Compliance agreements

A compliance agreement is a formal document that is agreed upon and signed by the Canada Revenue Agency and the registered charity. It outlines the identified problems, the steps the charity should undertake to remedy the problems and the consequences to the charity if it does not comply with the agreement.

Tax penalties

Table 11 summarizes the tax penalties that the Canada Revenue Agency can impose for various non-compliance infractions after it has exhausted education and compliance agreement sanctions. The Canada Revenue Agency has stated that in serious cases of non-compliance it is prepared to impose penalties, suspensions or revocation immediately, without invoking an education or compliance agreement.

25. Canada Revenue Agency "Guidelines for Applying the New Sanctions."

Table 11: Summary of intermediate sanctions and penalties²⁶

		Penalty for first infraction	Penalty for repeat infraction	
Infraction	Late filing of annual information return (T3010A)	\$500 penalty		
	Issuing receipts with incorrect information	5% penalty on the eligible amount stated on the receipt	10% penalty on the eligible amount stated on the receipt	
	Failure to keep proper books and records	Suspension of tax-receipting privileges		
	Charitable organization or public foundation carrying on an unrelated business	5% penalty on gross unrelated business revenue earned in a taxation year	100% penalty on gross unrelated business revenue earned in a taxation year and suspension of tax-receipting privileges	
	Private foundation carrying on any business	5% penalty on gross business revenue earned in a taxation year	100% penalty on gross business revenue earned in a taxation year and suspension of tax-receipting privileges	
	Public foundation acquires control of a corporation (acquired if the registered charity, or the charity plus a non-arm's length person(s), owns more than 50% of the corporation's voting shares)	5% penalty on dividends paid to the charity by the corporation	100% penalty on dividends paid to the charity by the corporation	
	Undue benefit provided by a charity to any person	105% penalty on the amount of undue benefit	110% penalty on the amount of undue benefit and one year suspension of tax-receipting privileges	
	Making a gift to an entity other than a qualified donee as defined in the <i>Income Tax Act</i>	105% penalty on the amount of the gift	110% penalty on the amount of the gift	
	Issuing receipts if there is no gift or if the receipt contains false information when the penalties:	do not exceed \$25,000	125% penalty on the eligible amount stated on the receipt	
		exceed \$25,000	Suspension of tax-receipting privileges and 125% penalty on the eligible amount stated on the receipt	
	Gifts of property to another registered charity so as to delay expenditures on charitable activities	The charities involved are liable to a 110% penalty of the fair market value of the property		
	Private foundations that fail to:	divest excess corporate holdings ²⁷	5% of value of excess holdings	10% of value of excess holdings for same failure within the last five years
		disclose certain information relating to the excess corporate holdings regime	10% of value of excess holdings	

26. Adapted from <http://www.cra-arc.gc.ca/tax/charities/policy/csp/penalties-e.html>.

27. For an overview of the excess corporate holdings regime for private foundations, see PricewaterhouseCoopers' *Tax Memo* "New Tax Era for Private Foundations" at www.pwc.com/ca/privatefoundations.

Penalties of more than \$1,000 can be reduced if funds are transferred to an eligible donee. An eligible donee is a registered charity that:

- operates at arm's-length with the charity that is subject to the penalties;
- has not had its receipting privileges suspended;
- has no unpaid liabilities under the *Income Tax Act* or *Excise Tax Act*;
- has filed all charity information returns for prior years; and
- is not subject to a certificate relating to suspected terrorism.

The Canada Revenue Agency may disclose a penalty notice to the public. A charity can object to penalties within 90 days of the date of mailing of the assessment. The objection should be in writing and should include the reasons for the objection and all of the relevant facts.

An appeal to the Canada Revenue Agency's decision on the objection can be filed to the Tax Court of Canada. If the penalty is paid or funds are transferred to an eligible donee, as discussed above, within one year after the penalty was first assessed, no interest will be charged on the penalty.

Revocation

The most severe consequence of non-compliance for a registered charity is revocation of its registered charity status. In 2006, 972 charity registrations were revoked due to the failure to file an annual return, 1,088 registrations were revoked at the request of the charity and 21 were revoked due to the charity's failure to comply with the *Income Tax Act*.

Table 12 summarizes the reasons for which the Canada Revenue Agency could revoke the registration of a charitable organization, public foundation or private foundation. A charity's registration is immediately revoked if the charity supports terrorist activity and therefore is the subject of a certificate under the *Charities Registration (Security Information) Act*.

Table 12: Reasons for revocation

		Charitable organization	Public foundation	Private foundation	Reference
Reason for revocation	Fails to file annual information returns				Income tax filing requirements (p. 18)
	Defers the annual disbursement requirements through gifts made between charities		Yes		Disbursement of funds to qualified donees (p. 4)
	Makes a false statement to obtain charitable registration				Federal registration (p. 9)
	Carries on an unrelated business			N/A	Carrying on a related business (p. 5)
	Carries on any business	N/A			
	Expends less than the disbursement quota each year on charitable activities and/or through gifts to qualified donees				Disbursement quota (p. 15)
	Acquires control of a corporation	N/A			Tax penalties (p. 24)
	Issues an incorrect receipt				Tax penalties (p. 24) and Receiving privileges (p. 11)
	Makes a disbursement in the form of a gift to a non-qualified donee or not in the course of charitable activities carried on by it ²⁸		Yes		Charitable activities outside of Canada (p. 8)
	Has a divestment obligation percentage at the end of the taxation year ²⁹	N/A			Excess corporate holdings regime for private foundations (p. 13)
	Supports terrorist activity				Revocation (p. 26)

28. Draft amendment (Bill C-10) applicable to gifts made after December 20, 2002.

29. For an overview of the excess corporate holdings regime for private foundations, see PricewaterhouseCoopers' Tax Memo "New Tax Era for Private Foundations" at www.pwc.com/ca/privatefoundations.

Voluntary revocation

A registered charity can voluntarily request revocation of its registration if it is winding down its operations or amalgamating with another charity.

Revocation consequences

A registered charity is deemed to have a year end at the end of the day of issuance of a notice of intention to revoke a charity's registration ("revocation year end"). In all other cases, the notice of intention to revoke a charity's registration is a letter sent by registered mail. The charity's registration is officially revoked by the publication of its name in the *Canada Gazette* if there is no objection or appeal within 90 days of the revocation year end.

The charity must file an annual information return, file Form T2046, *Tax Return Where Registration of a Charity is Revoked*, and pay revocation tax no later than one year from the date of Form T2051A, *Notice of Intention to Revoke a Charity's Registration*.

Box 2 outlines how revocation tax is calculated.

Box 2: Revocation tax

In basic terms, revocation tax taxes a charity on 100% of its net assets and allows the charity to reduce the tax over a period by donating its assets or using them on charitable activities. The tax is based on the total of:

- the fair market value of the charity's assets at the revocation year end;
- the total of the fair market value of assets transferred by the charity to another person within 120 days before the revocation year end; and
- the net income of the charity, including gifts received and other net income during the "winding-up period," i.e., from the revocation year end to the latest of the day:
 - the revocation year-end return is filed;
 - the notice of assessment is issued for the revocation year end; and
 - the Canada Revenue Agency can take collection relating to an objection or appeal by the charity.

Revocation tax is reduced by:

- debt outstanding at the revocation year end;
- expenditures made on charitable activities during the winding-up period not deducted from net income calculated above; and
- property transferred to an eligible donee (see the **Tax penalties** on page 24) within the winding-up period and no later than the later of one year after the revocation year end and the day the Canada Revenue Agency can take collection relating to an objection or appeal by the charity.

A charity will not be subject to revocation tax if it re-registers within a year after the revocation year end, provided it pays all amounts for which the charity is liable under the *Income Tax Act* before re-registration and files all outstanding information returns.

Revocation tax assessed at over \$1,000 can be reduced for a year after the revocation year end by spending funds on charitable activities or transferring property to eligible donees. The Canada Revenue Agency will not initiate any collection action for revocation tax until one year after the date of mailing of the notice of assessment.

Change in designation, annulments, objections and appeals

A registered charity can request a change in its designation if it disagrees with the Canada Revenue Agency's initial designation as a charitable organization, public foundation or private foundation. A charity can also request a change in designation if it wants its current designation changed. A change in designation can be requested by filing Form T2095, *Registered Charity Application for Redesignation*.

The Canada Revenue Agency annuls registration of a charity if it registered the charity in error or if, due to a change in law, the entity is no longer a registered charity. A charity that has had its registration annulled is not subject to revocation tax and the receipts it issued before the annulment are deemed to be valid, if they were valid when issued. The annulment letter sent from the Canada Revenue Agency may be disclosed to the public.

A charity that disagrees with the Canada Revenue Agency's notice of designation, revocation, refusal to register or annulment of registration can object to the notice in writing within 90 days of the date on which the notice was mailed. The objection must outline the reasons for the objection and the relevant facts.

The charity can appeal the Canada Revenue Agency's decision resulting from the objection to the Federal Court of Appeal. The Federal Court of Appeal's decision can be challenged through the Supreme Court of Canada.

Other non-charitable tax-exempt entities

The following non-charitable entities are exempt from income tax.

Non-profit organizations

A non-profit organization's (NPO's) net profits are exempt from income tax, but unlike a registered charity, the NPO does not have to register with the Canada Revenue Agency and has no tax receipting privileges. To be a non-profit organization for tax purposes:

- the organization must be:
 - a club, society or association that is not a charity; and
 - organized and operated exclusively for social welfare, civic improvement, pleasure or recreation, or for any other purpose except profit; and
- no part of the income can be payable to or made available for the personal benefit of any member, proprietor or shareholder.

Registered Canadian amateur athletic associations

A registered Canadian amateur athletic association (RCAAA):

- is an association that is created under Canadian law and is a resident in Canada;
- is an NPO;
- has, as its primary purpose and its primary function, the nation-wide promotion of amateur athletics in Canada; and
- has applied for registration, has been registered and its registration has not been revoked.

In addition to being tax-exempt as an NPO, an RCAAA has quasi-charity status in that it may issue tax receipts for gifts made by corporations, individuals and trusts to the RCAAA.

Registered national arts service organizations

A registered national arts service organization (RNASO) is defined as a national arts service organization that has been registered and whose registration has not been revoked. A RNASO is a tax-exempt NPO and can apply to be treated as a quasi-charity so that it can issue tax receipts for gifts made to it by individuals, trusts and corporations if:

- its exclusive purpose and exclusive function is the nation-wide promotion of arts in Canada;
- it is resident in Canada and was formed or created in Canada; and
- it complies with prescribed conditions.

Low-cost housing corporations for the elderly

Canadian-resident corporations constituted and operated solely for the purpose of providing low-cost housing for the elderly qualify for exemption from income tax. Low-cost housing is interpreted by the Canada Revenue Agency³⁰ to be “comfortable but modest rental accommodation at rent levels which are low relative to rent levels generally available for similar accommodations (other than subsidized or non-profit accommodations) in the same community.”

30. Canada Revenue Agency Technical Interpretation 9730835, dated February 2, 1998.

Agricultural organizations, boards of trade and chambers of commerce

Agricultural organizations, boards of trade and chambers of commerce are tax-exempt entities and must be organized and operated exclusively for social welfare, civic improvement, pleasure or recreation.

Labour organizations and benevolent societies

A labour organization is an association of workers of the same trade or of several allied trades, organized for the purpose of securing the most favourable conditions, wages or hours of work for its members.

A benevolent society or a benevolent or fraternal benefit society or order includes:

- a society or association whose members have adopted the same or similar calling, vocation or profession, or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause;
- an association having a representative form of government and a lodge system with a ritualistic form of government for meetings of its chapters or other substitute bodies; or

- a society or voluntary association organized and carried on for the mutual aid and benefit of its members, that ordinarily:
 - has a lodge system, a ritualistic form of work and a representative government; and
 - makes provision for the payment of death benefits and for benefits in case of accident, sickness, or old age from funds derived from dues paid or assessments levied on its members.

Municipal corporations and their subsidiaries

A municipal corporation is a corporation, commission, or association whose:

- capital is at least 90% owned by one or more municipalities in Canada or a municipal or public body performing a function of government in Canada;³¹ and
- income for the period from activities carried on outside of the geographical boundaries of the entity³¹ does not exceed 10% of the income for the period.

A subsidiary of a municipal corporation is also a tax-exempt entity.

31. Draft amendment (Bill C-10) applicable to taxation years that begin after May 8, 2000.

Non-profit corporations for scientific research and experimental development

A corporation that is constituted exclusively for the purpose of carrying on or promoting scientific research and experimental development (SR&ED) is a tax-exempt entity if:

- no part of its income is payable to, or can be made available for the personal benefit of, any proprietor, member or shareholder;
- it has not acquired control of any other corporation;
- during the period, it did not carry on business; and

- during the period, it expended in Canada generally more than 90% of the corporation's gross revenue on:
 - SR&ED directly undertaken by, or on behalf of, the corporation; or
 - a payment to an association, university, college or research institute to be used in SR&ED.

Mutual insurance corporations

A mutual insurance corporation that received its premiums wholly from the insurance of churches, schools or other charitable organizations is a tax-exempt entity.

For more information

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