

Recent Tax Developments

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On November 20th at the Eleventh Annual Canadian Conference for Charities and Not-For-Profit Organizations sponsored by The Canadian Centre for Philanthropy, the Minister of Revenue, the Honourable Otto Jelinek announced details of proposed changes in the administration of the income tax rules as they relate to registered charities. The Discussion Paper entitled *A Better Tax Administration in Support of Charities* was released at that time and comments were requested on the proposals outlined in it by January 31, 1991. (Since the time allotted for the submission of comments is so short, the Department of Finance will probably review any written comments even if they are not submitted by January 31, 1991.) The Discussion Paper should not be as controversial as the one released by the Department of Finance in 1983. In keeping with one of its stated themes, we understand that the document was mailed to all 63,000 registered charities.

As the title of the Discussion Paper denotes, the purpose of the proposed changes is to effect a better tax administration for the registered charities. The Discussion Paper outlines the background to taxation in the charitable and non-profit sector, the present approach by the taxation authorities, the reasons why changes are required at this time and, lastly, the proposed changes. The thrust of the Discussion Paper, as was that of the speech by the Minister of National Revenue on November 20th, is to provide a better understanding of the tax treatment of charities to the organizations themselves and a better administration of the tax rules as they apply to charities.

The suggested changes fall into three categories:

- clarification of the permissible activities for charities;
- promotion of greater openness in charities and in their activities as well as increased public confidence in the charitable and non-profit sector; and

- simplification of the Department's administration to make the system fairer for all.

First Category of Proposed Changes

In the first category, it is proposed that the types of permissible activities for charities be clarified.

First, it is proposed that more information in "plain language" will be made available concerning the interpretation of the meaning of "charitable" and the obligations of a charity under the *Income Tax Act*. This objective will be accomplished partly by the periodic release of decisions relating to areas of general interest (including new interpretations) based upon situations involving registrations, refusals (to register), and revocations.

Secondly, the government's intention is that, provided that the "business activity" of a charity is not a substantial commercial endeavour, it will consider that such an activity is a "related business" where some (but not necessarily all) of the following factors are substantially satisfied:

- 1) the activity is related to the charity's objects or ancillary to them,
- 2) there is no private profit motive since any net revenue will be used for charitable activities,
- 3) the business operation does not compete directly with other for-profit business,
- 4) the business has been in operation for some time and is accepted by the community.

These four tests will be applied but, as indicated above, it will not be necessary that all four factors be present in order to have the activity qualify as a "related business". Specifically covered is the hospital parking lot for patients and visitors; in this situation, the Minister has indicated that such an activity will be a related business notwithstanding that it may compete with privately-run parking lots.

Thirdly, an attempt will be made to ensure that registered charities use the donations they collect for the donors' intended purposes. One way of achieving this objective is to require charities to provide more information on Form T3010, the annual form that they are now required to file with Revenue Canada. This additional information would include more details on fund-raising expenses including the amounts paid to a fund-raising consultant in relation to fund-raising activities. Furthermore, more public information will be disseminated on the "expenditure test". As well, the *Income Tax Act* will be amended to ensure that

accumulated amounts that were excluded from the “expenditure test” are ultimately brought in a “receipted donations” in the year in which they are spent in order to complete the “loop” of accounting for such receipts and disbursements.

Specifically covered is the procedure now in place for donation receipts and related matters and in this connection no changes are to be implemented at this time, although some charities had expressed a view that the status quo stifled any innovation in their fund-raising activities.

The Government is now prepared to accept new arrangements for charities which operate abroad. These arrangements may involve performance contracts and other related arrangements which essentially require the Canadian charity to have responsibility for the expenditure of funds outside Canada. In addition, more information on these activities must be disclosed on the annual information return.

Lastly, the Government proposes to publish in “plain language” its views on political activities and in particular to explain a number of very difficult legal concepts such as “education”, “advocacy” and “nonpartisan”.

Second Grouping

In the second category, measures are proposed to promote openness and public accountability.

First, considerably more information will be available to the public with respect to a registered charity and its operations including the annual return (including the financial statements), notifications of late filings of the annual return as well as other actions by Revenue Canada, Taxation such as proposed revocations. The only information that will not be for public scrutiny is confidential information such as the names of donors and other sensitive data.

Furthermore, Revenue Canada, Taxation is proposing to indicate that the information disclosed by a particular charity has not necessarily been verified as to its accuracy. However, in order to improve the accuracy of the information on the annual returns, it is proposed that all registered charities be required to file audited financial statements, the audit being conducted by an external auditor. There may be an alternative available, whereby only the larger charities (those with gross revenue in the previous year in excess of \$250,000) would be required to file audited financial statements while smaller charities would be able

to file financial statement in a simpler format. Both the charitable sector and the accounting profession will be consulted about this proposal.

Third Category of Changes

The third set of proposed changes relates to streamlining the administrative process for charities.

Included as the first change in this area is the introduction of a simplified registration application form together with a layman's guide to the registration process.

Secondly, the government proposes a three-pronged approach to address the late filing problem:

- a campaign will be undertaken to inform the charities of the requirement to file an annual information return;
- where a charity had gross revenues of less than \$250,000 in the preceding year, the government will be providing a shorter and a simpler information return. An alternative may be available is an association is willing to accept responsibility for filing on behalf of its affiliates; and
- the government proposes more frequently to enforce revocation of the registered status of a charity if it fails to file the annual return after reasonable notice has been given.

Furthermore, as part of a continuing public relations program, Revenue Canada, Taxation will be explaining the audit process in greater detail before an audit commences. In addition, audits will tend to be concentrated on areas of concern rather than including all of the activities of the organization being audited.

Lastly, the government proposes to amend the *Income Tax Act* to allow the notice that is published in the *Canada Gazette* when charitable status is revoked, not only to include the name of the charity and its registration number, but also the grounds on which revocation occurred. Furthermore, a technical amendment will be made to the *Income Tax Act* in order to ensure that the funds of the charity are not misappropriated in anticipation of a forthcoming revocation. This amendment when enacted will provide that the value of assets relevant to this provision will be determined on the basis of their highest value in a 120-day period before the notice is received.

Clearly, the proposals in this Discussion Paper differ dramatically in effect from those contained in the 1983 Discussion Paper (*Charities and*

the Canadian Tax System); however, the full impact of the proposals is difficult to assess given the short period of time for the submission of comments and the absence of draft wording. Furthermore, the consequences may be more dramatic for one charity or group of charities than for charities in general. Nevertheless the government is seeking input from the approximately 63,000 charities and it is up to the individual charities to respond. If one or more of the proposals would create hardship for a particular registered charity or group of charities, a submission in writing should be made to the Minister of National Revenue. The time to react to the proposals is now, no when the process has advance so far that it would be very difficult (if not impossible) to bring influence to bear for significant changes.

Annual Report of the Auditor-General of Canada

In the Report of the Auditor-General of Canada to the House of Commons recently released, an entire chapter was devoted to the tax treatment of charities and non-profit organizations. This Report will be reviewed in the next edition of this journal.