

Canadian Federal Budget Increases Transparency for Charities

By Robert B. Hayhoe^[1]

The 2004 Canadian budget introduces major changes to the regulatory regime for charities. One of the most important changes in the long term is likely to be the introduction of increased transparency requirements for both charities and the Canada Revenue Agency.

Introduction

Among the very substantial changes to the Canadian charity tax regime announced as part of the March 2004 federal budget were a number of transparency initiatives. These changes have not yet received much attention from charities or charity lawyers, probably because of the more immediate impact of some of the other changes announced, including the introduction of intermediate sanctions, a new tax appeal process, and significant amendments to the disbursement quota spending requirements. Though these changes are certainly important, the changes dealing with accountability and transparency may prove to be just as important in the long term. This article will describe the budget changes, with particular attention to the transparency ones.

Joint Regulatory Table Report Background

The Canadian federal government has been engaged since 2000 in a consultative process called the Voluntary Sector Initiative ("VSI").^[2] One of the "tables" or working groups established under the VSI was the Joint Regulatory Table ("JRT"), tasked with making recommendations on procedural elements of charity tax law.^[3] The JRT conducted hearings across Canada and issued a preliminary report^[4] recommending various tax changes in the areas of intermediate sanctions, appeals, transparency, and institutional reform. In March 2003, the preliminary report was superseded by a final report^[5] that made minor amendments. The 2004 Canadian federal budget implements most of the JRT's final recommendations.

Non-Transparency Budget Changes

Before addressing the accessibility and transparency changes announced in the 2004 budget,^[6] I will first describe the other budget changes that have occupied commentators.^[7]

Intermediate Sanctions

The budget change that has attracted the most attention is the introduction of intermediate sanctions. Before the budget, the only sanction available to the Canada Revenue Agency^[8] in the case of a registered charity not complying with charity tax rules was revoking its charitable registration. Deregistration resulted in loss of the organization's tax exemption and of tax recognition for donors. As well, one year after deregistration, the charity was assessed a revocation tax equal to its assets at deregistration.^[9] Since deregistration gave rise to such severe consequences, the Canada Revenue Agency rarely imposed it. The result was that a significant number of charities felt able to act as if many aspects of charity tax law did not apply to them, while others were unnecessarily concerned about the possibility of revocation for minor tax transgressions.

The 2004 budget follows the recommendations of the JRT by introducing intermediate sanctions as part of a progressive approach to compliance. The first level of compliance action will be increased specific and general education for charities about the applicable tax rules. This is a positive development from the accessibility and transparency perspective. Indeed, even before the 2004 budget, the Canada Revenue Agency has been increasing the information it makes available to charities on various topics.^[10]

In somewhat more serious examples of non-compliance, the budget gives the Canada Revenue Agency more explicit power to use compliance agreements with charities.^[11] When non-compliance is seen as repeated or more severe, the budget introduces intermediate financial sanctions.^[12] While this article will not fully set forth how these will operate,^[13] they can be summarized as giving the Canada Revenue Agency the ability to suspend the eligibility of a charity to receive donations, or to assess tax of more than 100 percent of funds improperly spent.

Perhaps in response to constitutional concerns about the federal government's intruding into provincial jurisdiction by using the tax system to regulate the conduct of charities, the budget will permit a charity assessed more than \$1,000 in penalty tax in a year to pay it to an "eligible donee" instead of the federal government. An eligible donee is another Canadian registered charity that is fully compliant with tax rules and has a governing body that is arm's length from the governing body of the penalized charity.

The budget also maintains the Canada Revenue Agency's power to deregister in serious cases. The revocation tax will no longer be avoidable by granting to a "qualified donee," such as a foreign university.^[14] Instead, revocation tax can be avoided only by a grant to an "eligible donee" as defined above. The budget also confirms that the Canada Revenue Agency may annul a registration issued by mistake, and annulment will not result in any revocation tax or other denial of donors' tax recognition. Confirmation of this power is helpful, since the Canada Revenue Agency has been quietly processing annulments for some time.^[15]

Appeals

On registration issues, the pre-budget rules provided for judicial review by way of an appeal to the Federal Court of Appeal.^[16] This is a highly technical and complicated appeal route that does not permit new evidence to be introduced. The JRT recommended that charity tax appeals proceed to the Tax Court of Canada for trial *de novo*.^[17]

The budget includes a new internal Canada Revenue Agency objection process for reconsideration of all charity tax decisions. The budget also provides that all intermediate sanction appeals will then go to the Tax Court of Canada. However, the budget leaves registration appeals with the Federal Court of Appeal. Given that the Tax Court is a much cheaper and more accessible litigation forum than the Federal Court of Appeal, and given its much greater tax expertise, the budget's approach to appeals is an improvement but still a disappointment.

Disbursement Quota Changes

In addition to the changes designed to implement the JRT Report, the budget announces various technical changes to the disbursement quota rules. The disbursement quota requires that each Canadian registered charity that is a charitable organization expend on charitable grants or programs 80 percent of the amount of official donation receipts that it issued in the previous year, while a charitable foundation is required to expend 80 percent of the amount of official donation receipts that it issued in the previous year and 4.5 percent of investment assets.^[18] Note, though, that the Income Tax Act has always contained provisions permitting exclusion of endowment gifts from the 80 percent expenditure requirement.

A 4.5 percent net annual return has been quite difficult to obtain on endowment funds in some recent years, particularly given the fiduciary obligations imposed on charities managing endowments. As a result, the budget will reduce the 4.5 percent expenditure requirement to 3.5 percent for fiscal years starting after March 22, 2004. At the same time, the 3.5 percent disbursement quota will begin to apply to new charitable organizations immediately and to existing charitable organizations after 2008. The budget also contains a number of more technical provisions designed to correct various technical faults in the disbursement quota calculation mechanism dealing with transfers between charities and other matters.^[19]

Transparency and Accessibility Changes

The budget proposes to authorize the Minister of National Revenue to make a great deal more information available about applicants for registration, registered charities, and formerly registered charities. The budget also signals a continued commitment to increased transparency about the internal affairs and policies of the Canada Revenue Agency Charities Directorate.

Previous Proposals

A decade ago, the Canada Revenue Agency Charities Directorate did not function in a transparent manner. While it did make some policy guidance available to the public,[\[20\]](#) this guidance was quite general and often failed to address areas of real interest. At the same time, the information that the Charities Directorate could make available about individual charities was quite limited. In essence, the *Income Tax Act's* general confidentiality requirements[\[21\]](#) operated to prevent disclosure of any information about charities that was not permitted explicitly by that act.

Until 1998, the Charities Directorate was limited to disclosing the fact that an organization was registered, along with when it became registered, its location, and a portion of its annual information returns.[\[22\]](#) In 1998, the *Income Tax Act* was amended to provide for making additional information available[\[23\]](#) : a registered charity's application for registration, governing document(s),[\[24\]](#) and annual information returns. Even these explicit exceptions to the confidentiality requirements were interpreted narrowly by the Charities Directorate, though. For example, the availability of a charity's application for registration was undercut by the Charities Directorate's interpretation that the law did not require or even permit it to disclose any supporting documents that accompanied a registration application. Similarly, although the information return was a public document, the financial statement that each charity was required to attach was not made available, on the questionable theory that the statements did not form part of the information return.[\[25\]](#)

No information was publicly available about charities that had applied for and been denied registration. In the case of a charity that was being audited or was exposed to some compliance action, no information was available unless registration was revoked, and even then only the bare fact of revocation was public until 1998, when the letter of revocation, setting forth the reasons, also became available. These limitations hindered the ability of charities and their advisors to predict how the Charities Directorate might respond in particular situations.

Future Directions Initiative

Parallel to the JRT process, which was external to the Canada Revenue Agency, the agency carried out its own review of its effectiveness in various business lines, including charities. This review, known as the Future Directions Initiative, involved a series of consultations about the effectiveness of the Charities Directorate. Since the Canada Revenue Agency, under the Minister of Revenue, administers but does not draft tax law,[\[26\]](#) Future Directions did not address areas that might have required legislation, such as access to information about particular charities. However, the Future Directions Initiative reports[\[27\]](#) do address the organizational transparency of the Charities Directorate at some length and include a specific commitment to make all of its internal policy guidelines available to the public.

After the issuance of the Future Directions Initiative Report, the Canada Revenue Agency Charities Directorate moved quickly to implement the recommendations dealing with transparency. A significant number of internal Charities Directorate policy documents have now been made available on the Canada Revenue Agency's website. Further, the Charities Directorate has been going through its files, pulling advice letters provided to particular charities, and, where the advice given in the letter is correct, publishing excised versions. This new information[\[28\]](#) is a very helpful source of background on the Charities Directorate's positions on various issues.

The Charities Directorate has also introduced on its website a searchable database of registered charities, which can be used to confirm registration. It also links to a page summarizing the public portion of each registered charity's last few filed information returns.

Joint Regulatory Table Proposal[\[29\]](#)

The JRT Report addressed accessibility and transparency in detail. It acknowledged the need to balance the privacy interest of individual charities with the public interest in transparency and accessibility. However, in general the JRT came down on the side of more disclosure.

Registration

For applicants for registration, the JRT recommended that the Charities Directorate be required to give written reasons for registration decisions, with more detail in the case of novel applicants or refused applicants. Not only should this information be accessible, the JRT recommended that it be actively promulgated on the Charities Directorate's website. Beyond this information, though, the JRT accepted that an applicant's registration form, whether registration was successful or unsuccessful, should be available to the public only upon request. Any other documents in the application file should remain confidential. As a result of the JRT consultation process, it was recommended that an unsuccessful applicant should be given the opportunity to withdraw its application in the face of an intended refusal, thereby allowing the organization to avoid public disclosure.

Compliance

The JRT recommended that the existence of audit or other compliance action should not be public until a sanction is applied. While the report indicates considerable discussion of this issue, it was eventually decided that the existence of an audit of a particular charity could undermine public confidence in the charity.

Annual Return

The JRT Report complimented the Charities Directorate for beginning to make information returns available on-line. However, it criticized the position that the attached financial statements should not also be made available and suggested that the *Income Tax Act* be amended to require this disclosure.

Operational Guidance

The JRT confirmed the importance of the Charities Directorate's making more information about its operational positions available. While it acknowledged that such information has always been available pursuant to the *Access to Information Act*,[\[30\]](#) the JRT stressed the importance of having the Charities Directorate collect and publish its internal policies as guidance for charities and their advisors.

Budget Announcement Changes

The budget was designed to implement the JRT Report recommendations. It announced that virtually all of the accessibility and transparency recommendations would be made. Specifically, the budget includes the following new disclosure items for all registered charities[\[31\]](#) :

- financial statements filed with annual information returns; letters sent by the Canada Revenue Agency to a charity relating to the grounds for annulment of registration;
- the Canada Revenue Agency's decisions regarding a notice of objection filed by a registered charity; information that a registered charity has filed in support of an

application for special status or exemption under the Act, such as a request for permission to accumulate assets, as well as any responses from the Canada Revenue Agency; and

- the identification of a registered charity on which a sanction has been imposed, the type of sanction, and the letter sent to the charity relating to the grounds for the sanction.

For applicants ultimately denied registered charity status, the budget announces that the following materials will be made available, though with identifying information excised:

- the governing documents of the organization, including the statement of purpose; information disclosed by the organization in the course of making the application;
- a copy of the notice of denial; and
- a copy of any decision of the Canada Revenue Agency's Appeals Branch regarding a notice of objection filed by the organization.

In addition to the above information, the budget announced that the reasons for all registration decisions will begin to be made available.

These announced changes bring the JRT cycle to a close, at least in terms of transparency and accessibility. It will be interesting to see how these legal changes will be implemented by the Canada Revenue Agency and accepted by charities.

Notes

[1] Robert B. Hayhoe, a charity lawyer with Miller Thomson LLP in Toronto, Canada, is also the Canada Contributing Editor of IJNL and a member of the ICNL Advisory Council.

[2] For background on the Voluntary Sector Initiative, see www.vsi-isbc.ca; Arthur Drache, "Canada: The Next Step" (2000), 2:4 IJNL (http://www.icnl.org/journal/vol2iss4/cr_namerica.htm#Canada); Robert Hayhoe, "Recent Legal Developments Affecting the Not-for-Profit Sector" (2002), 4:2/3 IJNL (http://www.icnl.org/journal/vol4iss23/cr_na.htm); and Robert Hayhoe, "New Proposals for Federal Charities Regulation" (2002), 5:1 IJNL (http://www.icnl.org/journal/vol5iss1/cr_na.htm) (hereinafter "Hayhoe Proposals").

[3] In Canada, the provinces are generally accepted as having exclusive legislative jurisdiction over charities, leaving only federal tax rules subject to federal jurisdiction. For more detail, see Robert Hayhoe, "An Introduction to the Canadian Tax Treatment of the Third Sector" (2004), 6:2 IJNL (http://www.icnl.org/journal/vol6iss2/ar_hayhoe.htm#ftn12).

[4] Voluntary Sector Initiative, Joint Regulatory Table, Improving the Regulatory Environment for the Charitable Sector: Interim Recommendations (Ottawa: 2002) (http://www.vsi-isbc.ca/eng/regulations/pdf/interim_report_full.pdf).

[5] Voluntary Sector Initiative, Joint Regulatory Table, Strengthening Canada's Charitable Sector: Regulatory Reform (Ottawa: 2003) (http://www.vsi-isbc.ca/eng/regulations/pdf/final_report_full.pdf) (hereinafter "JRT Report"), as discussed in Hayhoe Proposals, *supra* note 2.

[6] Canada, Department of Finance, 2004 Budget Tax Measures: Supplementary Information at 349 (<http://www.fin.gc.ca/budtoce/2004/budliste.htm>) (hereinafter "Budget").

[7] Robert Hayhoe, "Canadian Federal Budget Introduces Intermediate Sanctions" (2004), 44 Exempt Organizations Tax Review 185.

[8] Canada's federal tax authority, once Revenue Canada and more recently the Canada Customs and Revenue Agency.

[9] With deductions for legitimate expenses and grants to other registered charities during the year: Income Tax Act, s.188, S.C. 1985, c.1 (5th Supp.) as amended (hereinafter "Income Tax Act").

[10] The best example is the significant increase in the volume of internal Canada Revenue Agency Charities Directorate policy materials now available on the Internet: <http://www.cra.gc.ca/tax/charities/glossary-e.html>.

[11] The Canada Revenue Agency already resolves audits by threatening revocation unless a charity provides a written undertaking to comply in future. See Canadian Magen David Adom for Israel v. Minister of National Revenue, 2002 FCA 323 (<http://decisions.fct-cf.gc.ca/fct/2002/2002fca323.html>), as discussed in Robert Hayhoe, "Case Comment: Canadian Magen David Adom for Israel v. M.N.R." (2002) 5:1 IJNL (http://www.icnl.org/journal/vol5iss1/cn_na-canda.htm).

[12] For more detail on the specific sanctions, see Budget, supra note 6 at 352-354.

[13] Partly because of length constraints and partly because the budget changes have only been announced in the form of a budget paper; the release of draft legislation should help clarify the details of intermediate sanctions.

[14] For a discussion of "qualified donees" in the context of international philanthropy, see Robert Hayhoe, "A Critical Description of the Canadian Tax Treatment of Cross-Border Charitable Giving and Activities" (2001) 49:2 Can. Tax J. 320.

[15] Canada Revenue charities Information Letter CIL – 1994 – 005 (<http://www.cra.gc.ca/tax/charities/policy/cil/1994/cil-005-e.html>) confirms that annulment was practiced in 1994.

[16] Income Tax Act, supra note 9, subsection 172(3).

[17] JRT Report, supra note 5 at 83.

[18] Income Tax Act, supra note 9, subsection 140.1(1)

[19] "Position Summary: Canadian Bar Association Charity & Not-For-Profit Law Section" (2002), 17 The Philanthropist 57.

[20] In the form of Interpretation Bulletins and Information Circulars.

[21] Income Tax Act, supra note 9, section 241.

[22] Income Tax Act, supra note 9, subsection 149.1(15)

[23] Income Tax Act, supra note 9, subsection 241(3.2).

[24] Letters patent, special legislation, constitution, bylaws, trust deed.

[25] JRT Report, supra note 5 at 63.

[26] Canadian federal tax legislation is the responsibility of the Minister of Finance.

[27] Canada Revenue Agency Guide RC 4313, Future Directions for the Canada Revenue Agency (<http://www.cra.gc.ca/E/pub/xi/rc4313/rc4313-e.html>).

[28]<http://www.cca-adrc.gc.ca/tax/charities/policy>.

[29] JRT Report, supra note 5.

[30] R.S.C. 1985, c.A-1.

[31] Budget, supra note 6 at 358.