THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

New Canadian tax changes create unmanageable burden for charities

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED JULY 6, 2023

Last week, I wrote about changes to our tax law coming into effect Jan. 1, 2024, which add more tax to high-income Canadians who choose to make large donations of securities to charities in the country. To add insult to injury, other recent changes will cause many of those donations – and in fact donations of many types, and even those of lesser amounts – to create a significant and unmanageable burden for charities.

The rules that create this burden were part of Bill C-32, which became law on Dec. 15. Make no mistake, this could close the doors of some charities. Let me explain.

The Rules

Just as individuals and corporations are required to file tax returns each year, trusts are also required to file an annual income tax and information return (called a T3 return) – with some exceptions.

Bill C-32 included new trust reporting rules, which expand the number of trusts required to file each year, including "express trusts" (trusts created knowingly or intentionally by a person). The new rules apply to trust year-ends of Dec. 31, 2023, or later. The penalties for failing to file are big, amounting to the greater of $2,500 or 5 per cent of the value of the trust property.

Here's the problem: Many people donate money to charities with instructions to hold the funds and use them for certain purposes, at certain times, or under certain conditions. Many of these arrangements are considered to be express trusts.

Take an example where a person donates to a university where the funds are to be held to provide annual scholarships to students who need financial assistance. Or consider a donor who sets up a "donor-advised fund" (DAF) where a donor contributes money to a charitable foundation and then, each year, advises it which charities should receive grants from the DAF.

Any time money is donated with time or use restrictions or conditions on use of the funds, it will often be the case that an express trust exists. Experts call these "internal express trusts" because they are

internally administered by the charity (as opposed to being the charity itself).

The Impact

So, if a charity holds funds that are express trusts, the new rules require the charity to file a separate T3 return for each trust, along with a new Schedule 15 to accompany each T3.

Consider a real-life example of community foundations, which could easily have 100 or more DAFs in place (I myself sit on one: the board of the Burlington Community Foundation). A foundation would have to first determine what funds it holds that might be considered express trusts, which would depend on the agreement signed with each donor.

The foundation will have to hire a lawyer familiar with the rules to assess whether each DAF is an express trust or not. This could cost thousands of dollars. If express trusts exist, the foundation will have to file T3 returns – potentially one for each DAF.

And for many charities, who might employ one or two people, the administrative burden of filing upward of 100 or more tax returns for express trusts will simply be impossible, not to mention that the employees are unqualified to complete these filings. If the charity hires an accounting firm to do the work, this could easily cost $100,000 or more in fees.

And by the way, if the charity fails to file, say, 100 returns, it will face penalties of $250,000 ($2,500 per return) or 5 per cent of the affected donated – whichever is higher. Those penalties are charitable dollars that would be paid to the Canada Revenue Agency.

The Discussions

This isn't just fearmongering. I spoke last week with charity lawyer and expert Terrance Carter, who has written on this subject with his colleagues Theresa Man, Jacqueline Demczur and Lynne Westerhof.

Mr. Carter and his colleagues have had recent discussions and correspondence with senior officials at the Department of Finance and the CRA, which have made it clear that the intent of the new rules is to include internal express trusts held by charities.

In the United States, there's no separate reporting requirement for such trusts, and Britain has specifically excluded internal express trusts from filing requirements. There is absolutely no tax policy being achieved by requiring charities to file returns this way. Charities are already required to file a Registered Charity Information Return (Form T3010) annually, which has all the information CRA needs to properly oversee the charitable sector.

The only ethical answer is for the Department of Finance to revise the law to specifically exclude internal express trusts of registered charities from a requirement to file. Anything else is stealing donor dollars.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca