Submission on Improving the Regulatory Environment for the Charitable Sector

(Interim Recommendations of the Joint Regulatory Table of the Voluntary Sector Initiative)

NATIONAL CHARITIES AND NOT-FOR-PROFIT LAW SECTION
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PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Charities and Not-for-Profit Law Section, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved by the Executive Officers as a public statement of the National Charities and Not-for-Profit Law Section.

Submission on Improving the Regulatory Environment for the Charitable Sector (Interim Recommendations of the Joint Regulatory Table of the Voluntary Sector Initiative)

I. INTRODUCTION — SCOPE OF THE CONSULTATIONS

The National Charities and Not-for-Profit Law Section of the Canadian Bar Association (the CBA Section) is pleased to provide its written comments on the Interim Recommendations of the Joint Regulatory Table (JRT), published in August 2002 as *Improving the Regulatory Environment for the Charitable Sector*[1] (the consultation document). The CBA Section made an oral presentation to the JRT at the consultation meeting in Toronto in October 2002. We believe that the session was constructive, but it did illustrate that a number of issues remain. We would like to continue to be part of the process and we believe there is merit in continuing dialogue with representatives of CCRA and Finance Canada. We hope we can act as a facilitator in that regard.

The consultation document states that the JRT has a four-part mandate.[2] These are the four study and recommendation items referred to the JRT in the Voluntary Sector Initiative (VSI). The two "action" issues are not part of this consultation, but have been transferred to the internal policy process of CCRA. It seems

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1 www.vsi-isbc.ca/eng/joint_tables/regulatory/reports.cfm

2 *Ibid*, p. 4.

contrary to the spirit of VSI to exclude these from the more comprehensive consultative process.

The first action item removed is the simplification of the information return (T3010). The JRT website indicates that consultations on this issue are complete and the draft form has received approval-in-principle from the JRT.

The second action item is development and publication of guidelines on the type and degree of business activities registered charities can legally pursue. CCRA has published draft *Guidelines for Registered Charities on Related Business*[3] and comments are to be made directly to CCRA. The thrust of the proposed Guidelines is to decrease the ability of charities to increase income from earnings. Charities need earned income to reduce their dependence on income from donations to enhance their financial sustainability. It is unfortunate that the underlying policy direction, as opposed to technical interpretation of what is a related business, is not open for discussion by the sector. Contrast this position in Canada with the recommendation that the law in England be amended to encourage entrepreneurialism and to facilitate the ability of charities to carry on trading activities directly[4].

Governments are increasingly encouraging "public-private partnerships" among charities, governments and the private sector. While certain government initiatives push charities into these partnerships, often against their better instincts, the draft Guidelines threaten revocation for carrying on business activities if they engage in these partnerships. It is disappointing that the related business issue is not fully engaged by the JRT, rather than being sidelined to asking the sector to respond to CCRA Guidelines outside of the VSI process.

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3 www.ccra-adrc.gc.ca/tax/charities/consultation_policy-e.html

4 "Private Action, Public Benefit", Strategy Unit Report, September 2002, pp. 43-44

II. ACCESSIBILITY and TRANSPARENCY

The first chapter of the consultation document focuses on registration and audits. The audits discussed seem to be exclusively those leading to revocation. It is not until a footnote in the Intermediate Sanctions chapter that we learn that CCRA does very few audits on a purely random basis. It would be useful if transparency included disclosure of how CCRA selects the charities to be audited.

The discussion seems to be based on the premise that an audit presumes culpable conduct. Why should the public trust in a charity be damaged "even if it were eventually found to be blameless"[5] unless the audited charity is presumed guilty until proven innocent? This seems to ignore the importance of developing a sophisticated program of random audits to gauge compliance, and that an audit can be part of a process increasing compliance by educating charities. This is difficult to achieve if the culture that an audit presumes culpability pervades the sector.

The consultation document makes no mention of the structural problems in the Charities Directorate's audits. These problems arise from contracting out audit work to personnel with have little or no expertise in dealing with charities, who are not on the staff of Charities Directorate. In the CBA Section’s view, no institutional change to improve accessibility and transparency is adequately addressed without considering the staffing and expertise of auditors.

It is a little disingenuous to worry about whether the public can find out the result of an audit when the charities all too frequently go for years without learning the result of their own audit. Many audits are never brought to a close. No audit program should begin until the regulator is confident that it has the resources and expertise to bring audits to a timely and definitive conclusion.

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5 Consultation document p. 8

1. Disclosure of Documents Before a Registration Decision

We agree with the recommendation that no information should be made public about an applicant prior to the regulator's decision[6]. However, the consultation document does not deal adequately with the applicant's right to disclosure by the regulator before a registration decision. Many times the regulator will seek information from public sources such as the Internet or newspapers. These materials find their way into the file without the applicant's knowledge. Even if the applicant does learn of them, it has no formal right to rebut the information. In light of Rothstein J.A.'s dissenting decision in *Canadian Magan David Adom for Israel*[7], procedural fairness demands that the regulator disclose all documents considered by the regulator to the applicant prior to its registration determination.

2. Disclosure of Documents After a Registration Decision

The consultation document recommends that reasons should be given, and should be publicly available, for every registration decision[8]. The CBA Section has a number of concerns about the practical application of this recommendation.

At present, registration letters are signed by individual examiners. The consultation document does not address who will sign these letters. If a registration decision is to have precedent value, it would seem that the Director General should sign it, in the same way that the Director General signs the final denial or deregistration letter.

It seems counter-productive to release information on the registration decision, without first clarifying what precedent the decisions have. If the regulator is

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6 Consultation document p. 10

7 Federal Court of Appeal, 2002 FCA 323

8 Consultation document p. 10

CCRA, does it have authority to say that all subsequent applications of a similar nature will be determined the same way once one decision has been taken?

The consultation document seems to tilt the basis of registration decisions away from the rule of law and towards administrative policy. This may be a reaction to the paucity of Canadian jurisprudence. Nevertheless, it is troubling that the implicit premise in the consultation document is that, if the regulator develops an administrative policy upon which to decide an issue of charity law, then that policy effectively becomes the law. The Canadian regulator does not have the power to make law accorded to the Charity Commission of England and Wales. Contrast this with the bold statement of the Charity Commissioners:

> We have the same powers as the court when determining whether an organisation has charitable status and the same powers to take into account changing social and economic circumstances - whether to recognise a purpose as charitable for the first time or to recognise that a purpose has ceased to be charitable. We interpret and apply the law as to charitable status in accordance with the principles laid down by the courts. Faced with conflicting approaches by the courts, we take a constructive approach in adapting the concept of charity to meeting the constantly evolving needs of society.[9]

Much good can result from a regulator applying the law creatively and progressively. However, there should be no ambiguity as to whether the regulator is limited to applying the law or has the power to change the law. Until the regulator has legal authority to shape the law, releasing registration decisions provides transparency without jurisprudential value. The VSI should be an exercise in clarifying the role of the regulator. However, any change must be rooted in the necessary changes in legal powers so that the regulator has authority to implement the new regime that will result.

The consultation document seems to presume that the regulator has, or will have, the quasi-judicial powers of the Charity Commissioners of England and Wales. In

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[9] Charity Commission Publication RR1a - *Recognising New Charitable Purposes*, October 2001, para. 8

several places it refers to the constitutional and other problems in setting up a quasi-judicial body. The impression is that the enhanced CCRA model is the most likely result. Consequently, the impact of a database with "precedents from previous decisions of the regulator"[10] is not clear . It is not helpful to raise expectations as to the jurisprudential power of the regulator if the regulator is merely going to be the existing CCRA with an enhanced website and communications policy. It must be clear the extent to which these decisions have precedent value or whether this will operate as an authority analogous to Advance Rulings provided by CCRA in other areas of the *Income Tax Act*.

The consultation document suggests that the legal basis for charitable registration is based upon, or requires, a single charitable classification. The preface cites a random selection of a dozen types of organizations that can be charities. The document cites one of the heads of charity in *Pemsel*.[11] It would be prejudicial to a charity's operations if a registration classified as "advancement of religion" precluded it from simultaneously carrying on activities to relieve poverty. This is not the existing law and it would be a retrograde step to force charities to fit into a single classification.

There is also no recognition of the additional cost of providing the reasoning that led to each registration. There are more than 4,000 applications each year. As the consultation document states, considerable success has been achieved in recent months in speeding the processing of registrations. It may serve a transparency purpose to have every registration explained. However, if transparency is at the cost of having each registration reviewed for consistency and the registration explained in terms understandable to the public, processing time will get worse again unless significant new financial resources are provided to the regulator.

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10 Consultation document p. 16

11 Consultation document p. 10; *Income Tax Special Purposes Commissioners v. Pemsel*, (1891) A.C. 531 (H.L.)

The consultation document does not disclose how many applications are refused or discontinued in a year. The limited number of appeals suggests that examiners are doing a better job than they are given credit for. If the movement of the appeal process to the Tax Court results in approximately 70 appeals in a year on 4,000 applications, the cost benefit result may suggest that it is a better use of limited resources to concentrate on publicizing the court decisions rather than having each examiner write a decision on every registration that will be available to everyone.

The lack of appreciation of the potential complexities is evident in the example of registration of a church requiring the examiner to state only that the applicant falls into the "advancement of religion" category[12]. The legal definition of religion is one of the most challenged aspects of charity law. This is recognized in England, where the Strategy Unit has proposed a statutory change recognizing multi-deity religions such as Hinduism.[13] In today's world, it will be a challenge for the regulator to demonstrate that the registration requirements for a Sikh temple or a Muslim mosque are not substantially different from a Christian church. The example also gives no sense of the "political activities" criteria that may influence a decision to register religious applicants.

In a time when there is cause for concern about the activities of extreme fundamentalist religious groups, the character and agenda of individual religious leaders may become a factor in granting or denying registration. Are there defamation implications in publishing denial of registration because a director or religious leader is a fundamentalist, zealot or a potential advocate of "terrorism"? To what extent have applications that raise concerns short of invoking the confidentiality provisions in the *Anti-terrorism Act* been factored in?

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12 Consultation document p. 10

13 Supra, note 4, p. 42

3. Impact on Non-Profit Organizations

The consultation document states that it "is, for practical purposes, impossible to develop a regulatory system that encompasses all charities and not-for-profit organizations that exist…As a result we have concentrated our attention on issues that pertain to registered charities.[14]" It is one thing for the JRT to ignore regulatory issues confronting the rest of the voluntary sector; it is quite another thing it to ignore how its recommendations for registered charities will impact the rest of the voluntary sector.

Publishing registration letters with the intent that the stated reasons for registration reflects the opinion of the regulator as to what is charitable has a potentially negative impact on the tax status of the rest of the voluntary sector. The vast majority of voluntary sector organizations[15] are non-profit organizations, defined in subsection 149(1)(l) of the *Income Tax Act* as being an organization "that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1)….".

Non-profit organizations operate without the certainty and protection of having their tax status designated. Apart from rare cases in which a ruling is provided, CCRA does not determine whether an organization qualifies for tax exemption as non-profit organization until after the organization's fiscal year is completed. Non-profit organizations have no certainty as to their tax exempt status for either the current or following years. If a non-profit organization fails to meet either the legal definition or activity test, then it is taxable.

The dissemination of reasoned registration letters has a potentially catastrophic impact on many non-profit organizations. This is because of the anomaly that "the

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14 Consultation document pp. 87-88

15 The consultation document incorrectly defines “not-for-profit organizations” at pp. 66-67. It even refers to the incorrect term — the *Income Tax Act* uses the term “non-profit organizations”

opinion of the Minister", rather than the common law, forms the basis for the statutory definition of a non-profit organization. If an organization has purposes that, in the opinion of the Minister, are charitable, then that organization cannot be a non-profit organization. "Charity" is a defined term in subsection 149.1(1) and is different from the term "registered charity" defined in subsection 248(1). Thus Notification of Registration letters would be binding for purposes of determining what organizations cannot be a non-profit organization.

The *Income Tax Act* has the rather punitive result that a charitable organization that is not a registered charity is taxable. Organizations which promote voluntarism, such as the Grand Forks Volunteer Society, have traditionally been considered non-profit organizations. The Minister recently changed the opinion as to the charitability of voluntarism and agreed to register the Grand Forks Volunteer Society as a registered charity. This is wonderful for the Grand Forks Volunteer Society because it was seeking registered charity status. Unfortunately, the change in the Minister's opinion means, strictly interpreting the statute, that every other volunteer society that has not applied for and been granted registered charity status is now taxable because, "in the opinion of the Minister", societies that promote voluntarism are "a charity within the meaning assigned by subsection 149.1(1)". The dilemma for lawyers practising in a self-assessing system is whether to advise clients of this or assume that CCRA will continue to assess these organizations as non-profit organizations.

The statutory definition of non-profit organization produces the result that an unregistered charity is taxable. While the consultation document has limited its focus to the legal and regulatory issues that directly impact registered charities, it is unwise to ignore the impact on non-profit organizations. CCRA's "administrative fairness letter" suggesting that an application for registered charity status will be denied routinely (and gratuitously) opines that the applicant likely qualifies as a "non-profit organization". In our opinion, registration letters should not be publicized until due consideration has been given to the impact of

this proposal on non-profit organizations. The impact would be widespread if the Minister were to change the opinion on whether sports or advocacy are charitable.

4. Documents Related to a Compliance Action

The statement that audits are "part of enforcing the law"[16] in the context of this section gives the impression that only bad guys get audited and they are presumptively guilty. The suggestion that making a charity's audited public will benefit the public trust in the sector implies that audits presume misconduct.

Again, it is important to establish the objective in disclosing documents related to a compliance action. The recommendation that questions about an audit can be disclosed only when there is a Tier 3 or 4 sanction suggests that disclosure is primarily a deterrence and punitive action.

The Orwellian world of audits of charities has become considerably worse with Sharlow J.A.'s majority decision in *Canadian Magan David Adom for Israel*[17]:

> A preliminary question is whether the Minister, having taken the position in the past that the provision of ambulances and related equipment to MDA was within the charitable goods policy, must continue to take that position. In my view, the Minister is under no such obligation. The Minister's obligation is to interpret the relevant provisions of the Income Tax Act and to determine how those provisions should be administered in each case, while ensuring that the affected person is given the appropriate degree of procedural fairness. The Minister does not breach any legal obligation merely by considering afresh the application of the relevant statutory provisions, even if the Act is applied less generously as a result.

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16 Consultation document p.12

17 Supra, note 7, para. 69

It not clear how the operations of charities will be improved by the regulator releasing operational guidance to charities if the regulator has no obligation to maintain consistency in interpreting provisions.

The Accessibility and Transparency chapter seems to deal only with registration and audits leading to sanctions and revocation. It would be more useful if it also focussed on administrative provisions that concern charities long before they reach the sanctions stage. Issues such as accumulations, ten-year directed gifts, calculation of allowable political activities and disbursement quotas are much more common problems for charities. It is a lost opportunity for the JRT to focus on regulatory problems of those charities entering or exiting the status of registered charity.

III. APPEALS

The CBA Section has previously supported moving the appeal process to the Tax Court of Canada. Consequently, there is little to add to the discussion of this issue in Chapter 2. However, some related issues should be discussed.

If the appeal process is moved to the Tax Court to reduce costs and increase the number of appeals, one consequence will be that the role of the regulator will be reduced to applying the law. With more court cases come more jurisprudence and the case for giving a quasi-judicial role to the regulator is reduced. Consequently, the consultation document is better to confine the regulator to the restricted compliance role presently held by CCRA. The educative and communication function of CCRA should be primarily communicating the jurisprudence of the courts rather than its own administrative policies, at least with regard to registrations.

The consultation document suggests that Tax Court hearing will be a trial *de novo*. There is no discussion of cases where the facts before court will be different from those upon which the regulator made its original decision to deny registration. This should be a matter for consideration when costs are awarded.

1. Factors in Defining "Charity"

The consultation document also fails to consider the extent to which CCRA rejects or refuses to apply common law jurisprudence from courts other than the Federal Court of Appeal. The most significant case is *Re Laidlaw Foundation*[18] on the issue as to whether amateur sport is charitable. Charity law articles from writers in England, cite *Re Laidlaw Foundation* as evidence that the Canadian courts have determined that amateur sport is charitable[19]. Only in Canada, when an organization applies to CCRA for registration, it discovers that Charities Directorate's definition of the common law does not include this and other provincial superior court decisions. As the English authors note: "Interestingly, despite the very clear reasoning in the judgment, the Canadian authorities have not yet incorporated the principle into the day to day administration of charity law".

While the meaning of charity at law is outside the remit of the consultation document, the CBA Section hopes that the Tax Court will have the opportunity to consider provincial jurisprudence. This is particularly timely since the Charity Commission has already recognized amateur sport as a charitable purpose[20], and

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18 [1986] 48 OR 549

19 For example, see Francesca Quint and Gordon Nurse "Promoting Sport and Charity Law" Charity Law & Practice Review , Vol.7, 2002, Issue 3 pp. 201-207

20 Charity Commission Publication - *Charitable Status and Sport*

the Strategy Unit has included "the advancement of amateur sport" as the seventh of the ten proposed enumerated heads of charity[21].

The consultation document seems to go out of its way to disrespect the provincial decisions:

> While the Directorate can look at charity decisions made at the provincial level (for example, decisions dealing with municipal taxation or the interpreting of wills) and similar cases in other countries, these are not binding in the case of charitable registration under the *Canadian Income Tax Act*[22].

No authority is given for this bold and radical statement. While the *Income Tax Act* gives the power to determine what a registered charity is to the Charities Directorate, the legislation does not define the term "charity". The Charities Directorate claims that the term is determined by the common law, yet it excludes provincial court decisions from the common law. No registration case in Canada cites provincial jurisprudence. Contrast this to the fact that a majority of them cite English, Australian and New Zealand jurisprudence.

This is particularly troubling when one considers that the *Constitution Act, 1867*[23] gives the provinces authority to make laws regarding the "establishment, maintenance, and management of charities in and for the province". If the regulation of charities is to work seamlessly across Canada, the provinces need to have a role.

One effect of denying provincial jurisdiction is to maintain the policy of excluding the influence of civil law in the charitable sector. The consultation document repeatedly states that the regulatory system relies on a common law

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21 Supra, note 4, p. 9

22 Consultation document p. 21

23 Subsection 92(7)

definition of charity. There is no mention of the *Federal Law - Civil Law Harmonization Act, No. 1*[24]. The opening words of the Preamble are:

> WHEREAS all Canadians are entitled to access to federal legislation in keeping with the common law and civil law traditions.

The *Income Tax Act* is clearly federal legislation. The consultation document states that the "federal government's regulatory involvement is premised currently on its authority to make rules regarding income taxes"[25]. The federal government has chosen not to legislate a definition of charity in the *Income Tax Act* but denies Canadians access to this federal legislation in keeping with civil law traditions.

Compare this to the situation with the law of gifts. No *Interpretation Bulletin, Information Circular, CCRA Pamphlet, Information Guide or Registered Charity Newsletter* mentions Québec law with regard to gifts. Yet many court cases on the law of gifts have applied civil law and the *Civil Code of Québec*. In *Plantae v. R.*[26], the Tax Court of Canada stated that since the *Income Tax Act* does not define gift, "we must rely on its usual meaning" and proceeded to cite the *Civil Code of Lower Canada*. CCRA has never cited these cases as authority for a civil law definition of gift in its publications[27].

The consultation document does recognize the civil law:

> The *Income Tax Act* does not define the term "gift" and organizations in Quebec are entitled to the application of the Civil Code in determining whether or not a contribution is a gift. This

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24 A.C. 2001, c. 4, brought into effect June 1, 2001

25 Consultation document p. 85

26 [1999] 2 C.T.C. 2631 (FCTD)

27 See Marcoux-Côté v. Canada 2000 D.T.C. 6615

> means gift can have a different meaning in different parts of the country.[28]

There is no rationale given as to why the definition of "gift" should be shaped by the *Civil Code* but "charity" is exclusively defined by the common law. This seems to contradict the *Federal Law - Civil Law Harmonization Act, No. 1,* which claims that the *Civil Code of Québec* "is the law which completes federal legislation when applied in" Québec.

2. Intervenors

It is unclear what the consultation document recommends with regard to intervenors[29]. It states that under the formal procedure in the Tax Court, a person claiming an interest in a proceeding can apply to the court for leave to intervene. At the same time, it does not want to allow third parties to challenge the regulator's decision to register an organization. Does the JRT oppose intervention in the Tax Court or does it only oppose any third party intervention prior to that stage?

It is important to clarify whether Finance Canada or other fiscal authorities are considered intervenors and play by the same rules as other third parties. If the regulator is applying the common law, the views of the Finance Canada on the fiscal implications are either not relevant at law or must form part of the record. Does the Minister of National Revenue represent the collective will and opinion of the federal government on desired policy directions or is the Minister applying the law as laid down in statute and interpreted by the courts?

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28 Consultation document p. 86 However, the second sentence seems to contradict subsection 8(1) of the Interpretation Act that states: "Every enactment applies to the whole of Canada, unless a contrary intention is expressed in the enactment."

29 Consultation document p. 33-34

In England, some of the most important case law was developed when the tax authorities challenged legal decisions because of the fiscal implications[30]. It is legitimate for fiscal authorities to be concerned about the cost to the public treasury of certain registration decisions. However, that issue should also be exposed in any transparency provisions. An applicant for a novel classification of charity should be entitled to know if registration is being denied because of fiscal concerns rather than policy concerns. Any discussions with fiscal authorities should be disclosed by the regulator.

IV. INTERMEDIATE SANCTIONS

1. Annulment of Registrations

Chapter 3 begins with a discussion of Charities Directorate's policy of annulling the registration of organizations it has registered in error. There is no statutory authority for this policy. The consultation document claims that "the power to annul a decision is inherent in any regulatory body as a means of correcting a decision made in error.[31]" There is no discussion of subsection 149.1(6.3), which states that once the Minister has designated a charity to be a charitable organization, private foundation or public foundation, then "the charity shall be deemed to be registered as a charitable organization, private foundation or public foundation, as the case may be, …until it is otherwise designated under this subsection or its registration is revoked under subsection (2), (3), (4), (4.1) or 168(2)"[32].

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30 For example, the Pemsel litigation was with the Special Commissioners for Income Tax and not with the Charity Commissioners.

31 Consultation document p. 56

32 This is a historic right going back to the present registered charity regime introduced in 1976. The original provision read:

(continued...)

If the regulator can claim a power of annulment that straightforwardly removes a statutory guarantee of continued registration, then it is difficult to accept that intermediate sanctions will be administered in good faith. This is but one of many instances where CCRA substitutes administrative policy for the rule of law.

2. Effectiveness of Current Penalties

The consultation document omits any serious discussion of the applicable penalty powers in the *Income Tax Act* other than the revocation tax. There is no mention of the tax on "non-qualified investments" in section 189 that is applied when a taxpayer benefits inappropriately from an investment relationship with a private foundation. Nor is there mention of the negative impact on a donor's donation tax credit in situations involving "non-qualifying securities" as defined in subsection 118.1(13). One sentence mentions the penalties triggered by misrepresentations by third parties in tax planning arrangements set out in section 163.2.

When the penalty provisions in section 163.2 were introduced, the explanatory provisions made it clear that they were intended to cover charities and their professional advisors. It is the CBA Section's opinion that almost all the offenses contemplated in the consultation document involving the issuance of donation receipts should be covered by section 163.2. It is very difficult to fraudulently or inappropriately issue donation receipts without participating in the making of a false statement as those terms are defined. The consultation document should explain why the gift penalties under section 163.2 are inadequate before seeking more penalty taxes.

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[32](...continued)
(3) An organization that, on December 31, 1976, was a registered Canadian charitable organization within the meaning of that expression for the purposes of the Income Tax Act as it read in its application to the 1976 taxation year, shall, after that day, be deemed to be a registered charity within the meaning of that expression for the purposes of the Income Tax Act as amended by this Act until such time, if any, as its registration is revoked.

Nor is there any discussion of the penalties in subsection 238(1) of between $1,000 and $25,000 if the charity does not comply with the requirements in subsection 230(2) related to donation receipts and financial records.

The consultation document recommends new penalties without exploring the effectiveness of the many penalties already in existence in the *Income Tax Act*.

It is possible that there are problems that require new penalties. However, it is wrong to suggest that the only weapon in CCRA's arsenal is revocation. Admittedly, section 163.2 may not authorize financial penalties on individuals connected with a charity for approving expenditures they know to be non-charitable[33]. However, we have doubts whether the regulator should have the authority to a levy a penalty on a charity official personally for the amount of expenditures on advocacy plus 25%, as the consultation document proposes. Presumably, the statutory penalties are to be in addition to, not in derogation of, the remedies available against organizations or directors personally through the courts applying the common law or provincial legislation. The addition of these penalties would not exclude sanctions applied by provincial regulators.

It is difficult to comment on the issue of intermediate sanctions without any guidance as to how the JRT anticipates them being applied to unrelated business activities of a charity. How does the JRT see financial penalties and other intermediate sanctions being applied to the unrelated business activities of registered charities? To what extent will the sanctions differ for charitable organizations and charitable foundations?

Since CCRA presently annuls registrations without regard to subsection 149.1(6.3), it is not surprising that there is no discussion of this statutory protection of charitable status when the consultation document proposes to

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33 As proposed in Consultation document p. 47

suspend a charity's status as a "qualified donee". How does the JRT see this sanction applied to the facts in *Canadian Magan David Adom for Israel?*[34]

One of the most common problems in the charitable sector is charities having their registration revoked for non-filing of the annual T3010. This is the most benign form of non-compliance, so at one level should only attract a Tier 1 sanction. It now results in revocation. The problem is whether "name and shame" sanctions will work. A significant number of non-filing situations arise simply because the address of the charity is that of a volunteer or professional whose relationship with the charity changed during the year. While it is not the responsibility of the regulator to find the charity in order to fulfil compliance requirements, it might be simpler, cheaper and more effective to require a back-up address. If the T3010 was mailed to an unresponsive address, sending multiple reminders is not going to help. Consideration should given to requiring charities to provide the address of a law office or some other external person to whom the reminder notice could be sent. Alternately, it could be sent to both of the officers or directors who signed the last T3010 on file.

The consultation document discusses the difference between discretionary and mandatory sanctions. It suggests that there is a problem in giving no discretion to the regulator as to whether a penalty must be imposed.

Prior to 1994, there was a non-discretionary financial penalty of $100 to a maximum of $2500 under subsection 162(7) for late filing of tax returns. Further, even though CCRA was advised that it had no discretion to waive the penalty, CCRA never imposed it. The Auditor General estimated that, if the penalty had been applied, it would have yielded $49 million a year.[35] The Auditor General expressed the opinion that the effect of not levying the late-filing penalty was a

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34 Supra, note 7.

35 Report of the Auditor General of Canada, "Charities, Non-Profit Organizations and the Income Tax Act", 1990, para. 10.57

disincentive for charities to meet the legislative requirements for filing and did not encourage voluntary compliance. In 1994, subsection 162(7) was amended to exclude registered charities from this penalty provision. It is not clear as to the extent to which this legislative history has been considered by the JRT.

3. When the "Problem" is Not the Charity

The consultation document says that the focus of Tier 2 sanctions should be working with charities to correct a problem. The consultation document implies that the "problem" will invariably be the charity's misinterpretation of the law, rather than originating with the regulator's application of the law. This is evident in the issue of whether private foundations were authorized to engage in "loanbacks". CCRA was not going to admit that the "problem" in *Jabs Construction Ltd. v. Canada*[36] was that Jabs insisted on its legal right to engage in a loanback rather than knuckle under to administrative policy on the issue.

CCRA was so intent on punishing Jabs for his intransigence on the "problem" that it invoked the discretionary general anti-avoidance rule (GAAR) in s. 245 of the *Income Tax Act* to impugn the tax planning. The court strongly rejected this characterization of the Jabs' donation:

> I can discern nothing else in the entire series of transactions that could possibly justify there being avoidance transactions, either separately or collectively. This transaction is the last one that would have occurred to me as subject to attack under section 245. Section 245 is an extreme sanction. It should not be used routinely every time the Minister gets upset just because a taxpayer structures a transaction in a tax effective way, or does not structure it in a manner that maximizes the tax.[37]

This case was heard before the enactment of section 163.2. Today, CCRA presumably would have sought to impose civil penalties against both the tax

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36 [1999] 3 C.T.C. 2556, 99 D.T.C. 729 (T.C.C.)

37 [1999] 3 C.T.C. 2556, 99 D.T.C. 729 at p. 738

advisor and the charity that implemented the tax planning. It is not clear how the JRT's proposals on intermediate sanctions would help protect either the taxpayer or the charity in situations like this.

The consultation document acknowledges that "gift can have a different meaning in different parts of the country."[38] We question how this conclusion is reconciled with subsection 8(1) of the *Interpretation Act*:

> Every enactment applies to the whole of Canada, unless a contrary intention is expressed in the enactment.

If "gift" can have different meanings, it has serious implications for the imposition of civil penalties under section 163.2. Imposing a civil penalty differently in Quebec than in common law provinces seems to violate CCRA's Fairness Pledge to "apply laws consistently and equitably" and to "ensure our clients are treated equally under similar circumstances."

The consultation document proposes that the money collected in financial penalties be "turned over to charitable purposes"[39]. It is an interesting proposal that the proceeds from the 100% penalty tax upon revocation be imposed in a way that ensures compliance with provincial cy-pres law.[40] The problem is that many charities have national operations. There would be some concern if charities with a head office in Toronto were to have their assets distributed to Ontario charities even if the money had been contributed by donors from all over the country.

The CBA Section strongly supports the proposal for the regulator to seek court injunctions to curtail the damage when immediate action is needed. This method of sanction puts the decision making authority in the hands of the courts.

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38 Consultation document p. 86

39 Consultation document p. 49

40 Consultation document p. 55

The proposal that specific grounds for deregistration be replaced with one general ground, "failure to comply with the requirements for registration as a charity,"[41] is met with less enthusiasm. Part of the concern is that, only two pages earlier, the consultation document recommends adding another ground for deregistering a charity, "that the registration was obtained on the basis of false or misleading information supplied by the organization in its application for registration".

Revocation for failure to comply with "the requirements for registration" is ambiguous. Is this the current requirements or the requirements in place when it was registered? A change in the jurisprudence on the meaning of "charitable" for one charity may subject “similar” charities to revocation. Implicit in this wording is that there will be no grandfathering for charities registered earlier based upon the correct application. The consultation document's discussion of annulments does not cover registrations that were not made as a result of "mistake".

Again, the consultation document proposes this without a discussion of relevant statutory provisions. A similar provision in subsection 149.1(6.5) allows revocation of a National Arts Service Organization's tax designation where "an incorrect statement was made in the furnishing of information for the purpose of obtaining the designation". It would be helpful to know about CCRA's experience with that provision before applying it to all charities.

We are of the opinion that it is better to provide specific grounds for revocation. There is enough trouble already due to lack of certainty in the interpretation of provisions governing registered charities. Revocation is a very final step and should only be undertaken with certainty as to the grounds used by the regulator.

V. INSTITUTIONAL REFORM

41 Consultation document pp. 58-59

Chapter 4 devotes much of its attention to promoting the role for an enhanced CCRA. While the consultation document acknowledges the assertion that CCRA has a conflict of mandates, the JRT has "not found evidence to support the assertion that such a conflict does, in fact, exist".[42]

We disagree. The conflict does exist and is most evident in the aggressive action taken by its auditors to challenge charitable gifts, especially those made by large donors. Once CCRA's auditors allege that a gift is motivated by tax planning or is otherwise "flawed", the Charities Directorate refuses to intervene or take any position to support the validity of the gift. Given that the government can speak with only one voice, CCRA is obligated to do nothing to assist the position of the recipient charity until the auditors or the courts have ruled on the validity of the gift.

In the history of the Charities Directorate involvement with charities, there have been no reported legal decisions in which CCRA intervened or litigated to preserve a gift to charity. The cases are legion in which CCRA has litigated to deny that the transfer of property to a charity was a gift. Every time CCRA wins that argument the result is to deny the charity of any financial benefit from the transfer of property to it.

One of the most egregious examples of CCRA seeking to deny a benefit to the charitable sector so that it could increase its tax revenues is found in *Jabs Construction Ltd. v. Canada*. Mr. and Mrs. Jabs engaged in sophisticated tax planning to save approximately $2,885,000 in taxes, which enabled them to make a gift of nearly $10 million to their private foundation. Responding to the Minister of Revenue's argument that the gift planning violated s. 245 of the *Income Tax Act*, Bowman J.T.C.C. wrote:

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[42] Consultation document p. 82

> The Minister sees the whole series of transactions as an elaborate and sinister form of tax avoidance. For the reasons that follow, I see it as no such thing. It is in my view a sensible and carefully conceived plan carried out within the specific provisions of the Act designed to achieve the overall charitable objectives of Mr. and Mrs. Jabs.[43]

Holding that gifts such as those made by the Jabs are "precisely what subsection 110.1(3) contemplates", Bowman J.T.C.C. pointed out the important distinction between "use" and "misuse" of the Act:

> I fail to see how the use of a specific provision of the Act that allows the tax consequences of a charitable gift to be mitigated can by any stretch of the imagination be a misuse of the provisions of the Act or an abuse within the meaning of subsection 245(4). It is simply a use of a provision of the Act - not a misuse or abuse - for the very purpose for which it was designed.[44]

CCRA knows the adverse impact on funding for the charitable sector. In *Jabs Construction Ltd.*, Bowman J.T.C.C. wrote :

> The Minister assessed in the manner set out at the beginning of these reasons, on the basis that the transfer to Felsen [Mr. and Mrs. Jab's private foundation] was ineffective, [and] the capital gain on the sale to Callahan belonged to the appellant [Jabs].[45]

CCRA would prefer that the charitable sector not understand that when it alleged that the transfer to Felsen Foundation was "ineffective", it meant not only that the donor should be denied a charitable deduction but also that the charity should be denied the gift. One's perspective on the resulting litigation changes with the realization that Mr. and Mrs. Jabs were spending their personal money in an attempt to benefit charity, while CCRA was spending taxpayers' money to enrich itself (and Jabs Construction) at the expense of charity. Charities Directorate

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43 [1999] 3 C.T.C. 2556, 99 D.T.C. 729 at p. 733 (T.C.C.)

44 *Ibid* at p. 738

45 *Ibid* at p. 738

either has a conflict of mandate or is actively seeking to discourage large gifts that involve sophisticated tax planning being donated to the sector.

There is need for a means to move the law forward rather than simply administer the *Income Tax Act*. Hopefully, this will be accomplished if there is a significant increase in jurisprudence because of the greater than before number of court cases. The JRT's energy would be much more productive if it focussed on changes that are clearly within the constitutional powers of the federal government rather than hypothesizing about a regulator having powers that are likely not available without involving the provincial governments.

VI. CONCLUSION

The consultation document spends a great deal of time responding with targeted measures to deal with specific problems. In our view, the problems are more systemic than specific. There is no doubt that existing provisions regulating registered charities and the rest of the voluntary sector are badly drafted and significantly deficient. It is not the mandate of this response to the Consultation document to embark in a detailed critique of the provisions of the *Income Tax Act*. It is our view that the time of the JRT would be better spent addressing the "root causes" of the problem. For example:

- There is no statutory definition of charitable purposes. However, there is a definition of charitable foundations based on purposes and a definition of charitable organizations based on activities.
- The definitions of "charity", "registered charity" and "non-profit organization" are confusing and should be redrafted.

If the statutory problems were significantly reduced, the identity and powers of the regulator would be less critical because the regulator’s tasks would be easier to carry out effectively and efficiently. Many of the problems in applying for registered charity status result directly from the dysfunctional provisions of the

Income Tax Act. Similarly, many of the dysfunctional aspects of regulation of the charitable sector result from poorly drafted laws related to disbursement quotas, related business, political activities, and other issues.

In our view, the JRT should call for a wholesale repeal and rewriting of the provisions in the *Income Tax Act* relating to the voluntary sector. The operations of both charities and the regulator would be much simpler if the JRT were given a blank slate paper to rewrite the law and remove the contradictions, errors and anomalies in the existing legislation. Many problems leading to noncompliance would be addressed by completely rewriting the regulations. Issues relating to the definition of charity, clarifying what purposes and activities are appropriate for charities, would be left to the jurisprudence resulting from more frequent appeals to the Tax Court.

Following our October meeting with the JRT, we continue to believe that legislation is required in many areas to solve the problems. We are concerned that the introduction of a new level of intermediate sanctions, without assurance as to how they will be administered, is likely to be problematic. We did not comment on many of the better aspects of the report during our October meeting with the JRT or in the written submission, since we wanted to focus on those areas where we thought we could offer productive and constructive advice. We believe a number of aspects of the recommendations are definitely a move in the right direction.

We recognize that the issue of related business is being dealt with elsewhere. We concluded that we would not deal with it in our submissions, since it is technically not part of the recommendations of the JRT. Nevertheless, we believe that this is a very important issue for the sector and it should be given high priority.

We pointed out at the October meeting that we have made submissions to CCRA and to Finance Canada on a number of issues, many of which are the subject of the JRT recommendations. We met with senior officials of both departments in January 2002 and we are continuing that dialogue. We encourage the JRT to recognize the need for a legislative solution to many of the problems identified and the need to focus on the difficult problems arising out of the separation of the federal and provincial jurisdiction.

We believe we can play an ongoing role in providing drafting assistance, advising on jurisdictional issues (which are not a problem in a unitary state, such as the United Kingdom), and otherwise assisting in the process.

Our major concern is that there does not appear to be a consistent view at the federal level about the need for legislation, in the face of clear administrative problems identified by CCRA. We hope that the JRT will recommend that legislation is required, even if this is perhaps perceived to be outside its mandate. We do not believe that a piecemeal approach to these issues would be successful.