

Intermediate Penalty for Charities: Improper Donation Receipts

A Paper

By

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By Theresa L.M. Man*

Abstract

New intermediate penalties and sanctions for registered charities that commit minor infractions of the requirements of the *Income Tax Act* (Canada) were implemented on May 13, 2005. These sanctions include monetary penalties and/or suspension of tax-receipting privileges. Two of the sanctions relate specifically to improper issuance of donation receipts containing incomplete information or false statements by registered charities. This paper reviews the background that led to the introduction of intermediate penalties relating to these two sanctions, as well as a general overview of the provisions imposing these penalties. Since the implementation of the intermediate penalties in 2005, there has not been any case law on how these provisions would be applied or interpreted by the courts. In general, the implementation of intermediate penalties on receipts by registered charities not in compliance with the Act or the Regulation is a welcome change. However, it remains to be seen how these provisions will be applied by CRA or interpreted by the courts.

A. Introduction

New intermediate penalties and sanctions for registered charities that do not comply with the requirements of the *Income Tax Act* (Canada) (the “Act”)¹ were implemented as a result of the enactment of Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004* (“Bill C-33”),² which received royal assent on May 13, 2005, and is now in force. These new intermediate penalties and sanctions, set out in section 188.1 of the Act, were proposed in the 2004 federal budget, which recognized that the tax authorities had

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¹ R.S.C. 1985, c. 1 (5th Supp.), as amended (hereinafter referred to as the “Act”).

² Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004*, i.e. *Budget Implementation Act, 2004, No. 2*, S.C. 2005, c. 19; given royal assent May 13, 2005 (hereinafter referred to as “Bill C-33”).

limited choices available for dealing with charities that commit minor infractions under the Act.³ Two of the new sanctions relate specifically to improper issuance of donation receipts containing incomplete information or false statements by registered charities.

This paper reviews the background that led to the introduction of intermediate penalties relating to the issuance of charitable donation receipts, reviews the provisions imposing these penalties and how these provisions would be applied.

B. The Need for Intermediate Sanctions

Prior to the enactment of Bill C-33, the only recourse that Canada Revenue Agency (“CRA”) could impose on a registered charity that did not comply with the requirements of the Act was to revoke its charitable status. The consequence of revocation is that the registered charity must, within one year of its deregistration, either transfer its assets to one or more qualified donees or pay a revocation tax under Part V of the Act, which is a 100% tax on the remaining property of the registered charity (i.e. transferring all of its remaining property to the Crown). Such a consequence would seem unduly harsh where non-compliance was inadvertent and minor, for example the late filing of the T3010 Registered Charity Information Return.

To overcome the harshness of imposing revocation for minor infractions, Bill C-33 introduced a more responsive approach to the regulation of charities under the Act by introducing sanctions that are more appropriate than revocation for relatively minor breaches of the Act. The Explanatory Notes to the proposed changes state that these penalties on registered charities are “more appropriate than revocation for unintended or incidental breaches of the Act,” and that these penalties apply in respect of “activities that charities are not permitted to undertake.”⁴ CRA further explained that these sanctions will be implemented as follows:

When minor infractions are identified, the CRA will work with the charity, through a compliance agreement, to rectify the problem. These agreements will set out the concrete steps a charity must take to comply with the rules, as well as the consequences of continued infractions.

³ Canada, Department of Finance, 2004 Budget, Notice of Ways and Means Motion to Amend the Income Tax Act, March 23, 2004, resolution 25 and Annex 9, Tax Measures: Supplementary Information. For a summary of the proposals contained in the 2004 federal budget, see Theresa L.M. Man and Terrance S. Carter, “March 2004 Federal Budget Rewrites Tax Rules for Charities” *Charity Law Bulletin* No. 41 (30 March 2004) (online: www.charitylaw.ca).

⁴ Canada, Department of Finance, *Notice of Ways and Means Motion and Explanatory Notes Re 2004 Federal Budget Measures* (Ottawa: Department of Finance, December 6, 2004).

Revoking a charity's status will remain as the ultimate sanction for severe breaches of the *Income Tax Act*, including continued, repeated, or cumulative infractions. For less severe breaches of the Act, intermediate sanctions include small penalties, temporary suspension of receipting privileges, and partial loss of the tax-exempt status. Repeated infractions will result in escalating penalties.⁵

1. The Joint Regulatory Report

Following the 1999 release of a report by the Voluntary Sector Roundtable, chaired by Ed Broadbent,⁶ on how to promote accountability and governance in the voluntary sector, voluntary sector members and federal officials met in three "Joint Tables" to make recommendations in relation to improving the regulation, administration and accountability of charities and other non-profit organizations, and to examine federal funding support. On August 28, 1999, the Joint Tables released their joint report, *Working Together, A Government of Canada/Voluntary Sector Joint Initiative*.⁷ As a result, the Joint Regulatory Table ("JRT") was formed in November 2000 to consider and make recommendations on (1) increasing the transparency of the regulatory process; (2) improving the system for appealing decisions made by the regulator; and (3) introducing a range of penalties for non-compliance with legal requirements.⁸ The JRT released its report, *Strengthening Canada's Charitable Sector: Regulatory Reform* (the "JRT Report"), in March 2003.⁹ The JRT Report made a number of recommendations affecting charities in Canada, including implementing a more effective and supportive regulatory framework, improving the accessibility and transparency of the regulator's framework and the appeals system, as well as implementing intermediate sanctions.¹⁰

⁵ Canada Revenue Agency, *Registered Charities Newsletter* No. 19, June 2004, at 6.

⁶ Panel on Accountability and Governance in the Voluntary Sector, *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector* (Ottawa: The Panel, February 1999). The Voluntary Sector Roundtable was formed in 1995 by twelve national umbrella organizations from the voluntary sector aimed at strengthening the voice of the voluntary sector in the community.

⁷ Federal/Voluntary Sector Joint Tables, *Working Together, A Government of Canada/Voluntary Sector Joint Initiative* (28 August 1999). The report delineated three areas requiring strategic investment and attention: (1) improving the relationship between the government and the sector; (2) enhancing the capacity of the sector to serve Canadians; and (3) improving the legislative and regulatory environment in which the sector operates.

⁸ Joint Regulatory Table, *Strengthening Canada's Charitable Sector: Regulatory Reform* (March 2003) (hereinafter referred to as the "JRT Report") at 2.

⁹ *Ibid.* Prior to releasing the final report, the JRT released its interim report in August 2002 and held public consultations across Canada in 21 cities.

¹⁰ See also Arthur B.C. Drache, "Regulatory Table Report Now Available" (June 2003) 11(6) *Canadian Not-For-Profit News* 42.

2. The 2004 federal budget and Bill C-33

Many of the recommendations of the JRT Report were reflected in the 2004 federal budget.¹¹ As noted above, changes proposed by the 2004 federal budget included, *inter alia*,¹² introducing new intermediate sanctions and penalties on registered charities for minor infractions of the requirements of the Act, introducing a new appeal regime for registered charities,¹³ and improving the transparency and accessibility of information concerning registered charities.¹⁴ Draft legislation implementing the proposed changes contained in the 2004 federal budget relating to registered charities were released on September 16, 2004,¹⁵ and further amended and consolidated on December 6, 2004.¹⁶ Bill C-33 was enacted on May 13, 2005.

C. Overview of Intermediate Sanctions

Section 188.1 contains a number of intermediate sanctions on registered charities that do not comply with the requirements of the Act. These sanctions include monetary penalties for late filing of Registered Charity Information Return, issuing incomplete donation receipts, carrying on prohibited business activities, foundations acquiring control of corporations, issuing donation receipts that contain false statements, transferring funds among charities to avoid disbursement

¹¹ *Supra* note 3.

¹² In addition to responding to the recommendations of the JRT Report, the 2004 federal budget also proposed sweeping changes to disbursement quota rules that apply to registered charities.

¹³ This included introducing a new internal reconsideration process and the appeal of taxes and penalties to the Tax Court of Canada.

¹⁴ This included the release of more information to the public concerning registered charities and organizations that are denied registration, inclusion of more information on official tax receipts, and increased information on the website of CRA.

¹⁵ Canada, Department of Finance, Legislative Proposals, Draft Regulations and Explanatory Notes relating to Income Tax (Ottawa: Department of Finance, September 16, 2004). For details of the changes contained in the draft legislation released on September 16, 2004, see Theresa L.M. Man and Terrance S. Carter, "Intermediate Penalties and Sanctions in September 16, 2004, Draft Amendments to the Income Tax Act" *Charity Law Bulletin* No. 54 (29 October 2004); Man and Carter, "Revocation and Annulment of Registered Charities in September 16, 2004 Draft Amendments to the Income Tax Act" *Charity Law Bulletin* No. 55 (30 October 2004); Man and Carter, "Trading of Charitable Donations, Appeal Regime, and Transparency and Accessibility of Information in September 16, 2004 Draft Amendments to the Income Tax Act" *Charity Law Bulletin* No. 56 (31 October 2004); and Man and Carter, "New Disbursement Quota Rules in September 16, 2004 Draft Amendments to the Income Tax Act" *Charity Law Bulletin* No. 59 (26 November 2004) (online: www.charitylaw.ca).

¹⁶ *Supra* note 4. For details of the changes brought by the December 2004 revised draft legislation, see Theresa L.M. Man and Terrance S. Carter, "December 2004 Amendments to the Income Tax Act Affecting Charities" *Charity Law Bulletin* No. 61 (12 January 2005) (online: www.charitylaw.ca).

quota, and conferring undue personal benefits.¹⁷ The tax-receipting privileges of a charity may be suspended if the charity fails to comply with certain verification and enforcement requirements (such as keeping proper books and records), issuing donation receipts that contain false statements where the penalty for such offence exceeds \$25,000 in a year, and upon repeat infractions of conferring undue personal benefits.

Some penalties are progressive, increasing in severity for repeat infractions within a period of five years. This period was originally proposed to be ten years in the September 2004 draft legislation. The ten year period was reduced to five years in the December 2004 draft legislation as a result of comments from the charitable sector that the ten year period was too harsh, particularly where there could be a whole new regime running a charity with no knowledge of past transgressions.¹⁸

These changes were introduced concurrently with amendments to section 189 of the Act, which introduced a process for assessment and dispute resolution. Section 189(7) of the Act provides that notwithstanding the application of intermediate sanctions, the Minister of National Revenue continues to have the authority to revoke the registration of a charity in respect of the same activities. The new intermediate sanctions set out in subsections 188.1 and 118.2 apply to taxation years that begin after March 22, 2004, with subsections 189(6.3) and (7) being in effect 30 days after Royal Assent, i.e. in effect after June 12, 2005.

D. Intermediate Sanctions Relating to Charitable Donation Receipts

Two of the new intermediate sanctions set out in section 188.1 relate specifically to non-compliance of the requirements under the Act and the regulations by registered charities when issuing donation receipts containing incorrect information or false statements. Details regarding these penalties are reviewed in this paper below.

¹⁷ Karen J. Cooper, “Changes to Sanctions, Penalties and Appeals Process for Charities” *Charity Law Bulletin* No. 82 (11 January 2006). See also Robert Hayhoe and Marc Owens, “Intermediate Sanctions: Lessons from the U.S. Experience” (Paper presented to the Canadian Bar Association/Ontario Bar Association 3rd National Symposium on Charity Law, 6 May 2005).

¹⁸ One can easily envision situations in which completely unrelated staff at different times, make similar mistakes in good faith. A shorter period is therefore more appropriate, in the absence of some form of culpable conduct.

1. Incorrect information on official donation receipts

a) Overview

Subsection 188.1(7) of the Act imposes a penalty equal to 5% of the amount reported on an official donation receipt as representing the amount in respect of which a taxpayer may claim a deduction under subsection 110.1(1) or a credit under subsection 118.1(3), if the receipt is “otherwise in accordance with [the] Act or the regulations.” Pursuant to subsection 188.1(8) of the Act, the penalty upon repeat infractions within five years is increased to 10% of the amount shown on the receipt.

Such a penalty may only be assessed against the registered charity that issued the receipt that violates subsection 188.1(7), as opposed to the intermediate penalty pursuant to subsection 188.1(9) which may also be assessed against the person who made a false statement on a receipt. The Explanatory Notes to the proposed changes indicate that such a penalty would apply to receipts that include incorrect information or receipts that do not contain all of the information required by the Act and the *Income Tax Regulations* (the “Regulations”).¹⁹

b) Requirements for receipts

Subsections 110.1(2) and 118.1(2) of the Act provide that corporations and individuals may not deduct an amount in respect of a gift unless the gift is evidenced by a receipt containing prescribed information. In this regard, Regulations 3501 and 3502 in Part XXXV of the Regulations set out the information required to be included on official receipts for donations and gifts. An official receipt issued by a registered charity must contain the following information “clearly, in such a manner that it cannot be readily altered”.²⁰

- i) a statement that it is an official receipt for income tax purposes;
- ii) the name, address and charitable registration number of the charity issuing the receipt;²¹

¹⁹ *Supra* note 4.

²⁰ Regulation 3501(1). These requirements are also applicable to registered Canadian amateur athletic associations and registered national arts service organizations. Regulation 3501(1.1) imposes similar requirements on official receipts issued for gifts received by other entities, e.g. gifts to the Crown, gifts to municipalities. See also Canada Revenue Agency, *Interpretation Bulletin* IT-110R3, “Gifts and Official Donation Receipts,” 20 June 1997, Part II; RC 4108 “Registered Charities and the Income Tax Act” at 7-8; and *Summary Policy* CSP-R02, “Receipts – Official donation receipts,” 25 October 2002 (revised 13 September 2005). See also Canada Revenue Agency, “Samples – Official Donation Receipts”, 19 October 2005.

²¹ See Canada Revenue Agency, *Policy Commentary* CPC-015, “Official donation receipts – Whether the registered charity’s address required on an official donation receipt can be a post office box, rather than a physical address,” 21 October 1998.

- iii) the serial number of the receipt;
- iv) the place where the receipt was issued;
- v) where the donation is a cash donation, (1) the day on which or the year during which the donation was received and (2) the amount of the cash gift;
- vi) where the donation is a gift of property other than cash, (1) the day on which the donation was received, (2) a brief description of the property, and the name and address of the appraiser if an appraisal is done; (3) the fair market value of the property at the time when the gift was made;
- vii) the day on which the receipt was issued where that day differs from the day the donation was received;
- viii) the name and address of the donor, including the first name and middle initials of the donor in the case of an individual;²²
- ix) the signature of a “responsible individual who has been authorized by the [charity] to acknowledge donations.”

Concurrent with the introduction of section 118.1 of the Act, it is also proposed that Regulations 3501 and 3502 be amended to require donation receipts issued after 2004 contain the name and website address of CRA.²³ Regulation 3501 has also been proposed to be amended to require receipts to contain a description and the amount of the advantage, if any, and the eligible amount of the gift for gifts made after December 20, 2002.²⁴

Furthermore, regulation 3501(2) requires receipts be signed personally. Regulation 3501(3) sets out the circumstances under which an official receipt may bear a facsimile signature. A receipt that contains incorrect or illegible information in relation to (1) the date on which the donation was received, (2) the year during which donation was received, or (3) the amount of the donation was “incorrectly or illegibly entered,” is a “spoiled receipt,” which is required to be “cancelled” by the charity.²⁵ Where a receipt needs to be replaced, Regulation 3501(4) sets out how this may be done.

²² See Canada Revenue Agency, *Policy Commentary* CPC-010, “Official donation receipt – Whether receipts can be issued in a name other than the donor’s,” February 21, 1994.

²³ See Canada Revenue Agency, “Regulatory Reform: New requirements for official donation receipts – Questions and Answers,” December 2, 2005.

²⁴ This requirement was first proposed in the draft technical amendments to the Act released on December 20, 2002 as a result of the new rules requiring split-receipting permitting a donor to receive a donation tax receipt even in situations where the donor or someone else received an advantage as a result of the gift. Other than regulation 3501, similar amendments are also proposed for regulation 3501(1.1), 3501 (6), 2000(1) and 2000(6). This proposed amendment was brought forward and included, without further changes, in the revised draft technical amendments to the Act that was released on February 27, 2004 and then in the legislative proposals released on July 18, 2005. To-date, this proposed requirement, once enacted, will become retroactive to gifts made after December 20, 2002. See also *supra* note 20, CRA, sample official donation receipts.

²⁵ Regulation 3501(6) defines “spoiled” receipts to be official receipts on which the date on which the donation was received, the year during which donation was received, or the amount of the donation was “incorrectly or illegibly entered.” Regulation 3501(5) requires “spoiled” receipts be cancelled by the charity.

c) Inadvertent mistakes

Registered charities have to ensure that all of the above required information is contained in the receipts they issue. They also have to ensure that other requirements under the Act and the Regulations regarding receipts are complied with, e.g. cancellation of a spoiled receipt, and when and how to include facsimile signatures on receipts.

The intermediate penalty set out in subsections 188.1(7) and (8) for incorrect or incomplete receipts apply only in circumstances where subsection 188.1(9) does not apply. This means that if any of the requirements relating to official donation receipts are not complied with, but short of containing a false statement referred to in subsection 188.1(9), the charity would be subject to the penalty provisions set out in subsections 188.1(7) and (8), rather than the more severe penalty set for false receipts.

Accordingly, these penalties would appear to be designed to apply to situations where charities issue official receipts that do not comply with the requirements under the Act or the Regulations as a result of an honest mistake or inadvertent oversight, for example, not containing the address of the charity or the date of receipt of the donation. Therefore, if a receipt contains incorrect information or if a receipt is incomplete, a determination will first need to be made whether the incorrect or missing information constitutes a “false statement” on the receipt pursuant to subsection 188.1(9). If the determination is negative, then the lesser penalty pursuant to subsections 188.1(7) and (8) would apply, rather than the more severe penalty for false receipts pursuant to subsection 188.1(9).

2. False statements on official donation receipts

Subsection 188.1(9) of the Act imposes a penalty equal to 125% of the amount shown on a receipt if it contains a false statement. Specifically, it provides as follows:

If at any time a person makes or furnishes, participates in the making of or causes another person to make or furnish a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct (within the meaning assigned by subsection 163.2(1)), is a false statement (within the meaning assigned by subsection 163.2(1)) on a receipt issued by, on behalf of or in the name of another person for the purposes of subsection 110.1(2) or 118.1(2), the person (or, where the person is an officer, employee, official or agent of a registered charity, the registered charity) is liable for their taxation year that includes that time to a penalty equal to 125% of the amount reported on the receipt as representing the

amount in respect of which a taxpayer may claim a deduction under subsection 110.1(1) or a credit under subsection 118.1(3). [emphasis added]

Paragraph 188.2(1)(c) provides that if the total penalty pursuant to subsection 188.1(9) for a taxation year exceeds \$25,000, then the registered charity's tax-receipting privileges shall also be suspended for one year. The penalty remains the same upon repeat infractions of the same offence by a charity.

Subsections 188.1(7) and (8) provide that they would apply only in circumstances where subsection 188.1(9) does not apply. In other words, if a receipt contains a false statement, an intermediate penalty under subsection 118.1(9) would apply, but the lesser penalty for an incomplete receipt under subsection 188.1(7) would not apply.

a) Application of subsection 163.2 of the Act

The wording of subsection 188.1(9) is very similar to the wording contained in subsection 163.2(2) of the Act, which imposes third-party civil penalty on planners (i.e. planner penalty). Specifically, the clause "... makes or furnishes, participates in the making of or causes another person to make or furnish a statement that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct ... is a false statement ..." are contained in both provisions. In this regard, jurisprudence and CRA's views in relation to the interpretation of subsection 163.2(2) would be helpful in understanding how subsection 188.1 will be interpreted.²⁶

It is also interesting to note that the drafters of subsection 188.1(9) decided to mirror the wording for planner penalty contained in subsection 163.2(2), rather than subsection 163.2(4), which imposes third-party civil penalty on preparers (i.e. preparer penalty).²⁷

Subsection 188.1(9) also specifically provides that only the definition for "false statement" and "culpable conduct" contained in subsection 163.2(1) applies to subsection 188.1(9). However, although subsection 163.2(1) contains definitions for the words "person" and "participate," which are also contained in subsection 188.1(9), these definitions do not apply when interpreting subsection 188.1(9). In this regard, the opening wording of subsection 163.2(1) provides that the "definitions in this subsection apply in this section" (i.e. section 163.2), and subsection 188.1(9) does not contain any provision that would make these definitions apply to

²⁶ See Canada Revenue Agency, *Information Circular* IC 01-1, "Third-Party Civil Penalties," September 18, 2001.

²⁷ See discussion below in this article regarding on whom subsection 188.1(9) would apply.

subsection 188.1(9). Similarly, other provisions contained in section 163.2 that apply to subsection 163.2(2) planner penalty do not apply to subsection 188.1(9), e.g. the good faith defence provided in subsection 163.2(6), or deeming of two false statements as one false statement under certain circumstances in subsection 163.2(8).

b) On whom the penalty may be imposed

Subsection 188.1(9) provides that the penalty may be imposed on a “person” who made a false statement of a receipt. “Person” is defined in subsection 248(1) of the Act to mean an individual, a corporation or any entity exempt from tax under Part I of the Act pursuant to subsection 149(1), e.g. registered charities, non-profit organizations, Crown corporations, municipalities, etc. Although the definition of the word “person” in subsection 163.2(1) includes partnership, it does not apply to subsection 188.1(9). However, there does not appear to be any policy reason not to include partnership in the definition of “person” in subsection 188.1(9).

Subsection 188.1(9) also provides that if the person who made the false statement is “an officer, employee, official or agent of a registered charity,” then the penalty will be imposed on the registered charity instead. However, in relation to third-party civil penalty pursuant to section 163.2, CRA has indicated as follows:

A corporation acts through its officers (i.e. employees including members of the board of directors); if an officer knew of the false statement, or was reasonably expected to know but for culpable conduct; *both* the officer and the corporation might be exposed to the penalties. ... Where the facts show that an employee had engaged in a situation subject to third-party penalties without the knowledge of the employer, only the employee will be subject to the penalties.²⁸ [emphasis added]

Since subsection 163.2(2) does not contain wording similar to that contained in subsection 188.1(9), it is not clear whether the same rationale expressed by CRA in the quotation above would apply when imposing the penalty on a registered charity under subsection 188.1(9) if the “person” who made the false statement is “an officer, employee, official or agent” of the charity. If so, then both the person who is an “officer, employee, official or agent” who issued the receipt and the registered charity could be exposed to the penalty.

Subsection 188.1(10) provides that if a person is liable for both the third-party civil penalty under section 163.2 and the intermediate penalty under subsection 188.1(9) in respect of

²⁸ *Supra* note 26 at para. 68.

the same statement, then the penalty is limited to the greater of those two penalties. CRA explained that the planner penalty in subsection 163.2(2) is “directed primarily at those who prepare (or participate in), sell or promote a tax shelter or tax shelter-like arrangement” and the preparer penalty in subsection 163.2(4) is “directed at those who provide tax-related services to a taxpayer.”²⁹ Examples of where the planner penalty could be applicable include “tax shelter promoters holding seminars or presentations to provide information in respect of a specific tax shelter; and appraisers and valuers preparing a report for a proposed scheme/shelter that could be used by unidentified investors.”³⁰ The preparer penalty, on the other hand, could apply to “a person preparing a tax return for a specific taxpayer; a person providing tax advice to a specific taxpayer; and an appraiser or valuator preparing a report for a specific taxpayer or a number of persons who can be identified.”³¹

Therefore, with subsection 188.1(10) contemplating that a person could be subject to a penalty under both subsection 188.1(9) and section 163.2, it means that the intermediate penalty for false statements pursuant to subsection 188.1(9) could apply to all of the above “persons,” including tax professionals, tax return preparers, accountants, advisors, practitioners, brokers, tax or financial planners, appraisers, valuers, and tax shelter promoters, as well as any other persons involved in making a false statement on a receipt, such as gift planners, fundraisers, and even the donor himself/herself.

c) Level of activity

Subsection 188.1(9) provides that the penalty would be imposed on a person who “makes or furnishes, participates in the making of or causes another person to make or furnish a statement.” It would appear that subsection 188.1(9) contemplates a “person” who has made a false statement to have taken an active role in making the statement. In this regard, the words “makes,” “furnishes” and “causes” requires the person to take an active role in this regard.³²

As explained above, the definition of the word “participate” in subsection 163.2(1) only applies to third-party civil penalties under section 163.2, but does not apply to subsection 188.1(9). *Black’s Law Dictionary* defines “participation” to mean “the act of taking part in

²⁹ *Ibid.* at para. 6.

³⁰ *Ibid.* at para. 7.

³¹ *Ibid.* at para. 9.

³² Brian R. Carr and Grace Pereira, “The Defence Against Civil Penalties,” (2000) 48(6) *Canadian Tax Journal* 1137, at 1157.

something, such as a partnership, a crime, or a trial.”³³ The court in *R. v. Solano*³⁴ agreed with the interpretation of the meaning of the word “participate” as set out in *Tax Evasion in Canada* by Williams I. Innes,³⁵ from which the court quoted with approval as follows:³⁶

The concept of participate in an offence seems reasonably clear, in that it would *involve actively joining in the conduct of a person committing an offence* under the Act. [emphasis added]

It is interesting to note that subsection 188.1(9) does not contain the words “assents to” or “acquiescence in” that are in subsection 163.2(4) with respect to the preparer penalty. Both of these words appear to refer to a person’s tacit or passive acceptance, approval or permission. In this regard, *Black’s Law Dictionary* defines “acquiescence” to mean “a person’s tacit or passive acceptance; implied consent to an act,” and defines “assent” to mean “agreement, approval, or permission.”³⁷ The court in *R. v. Rogo Forming Ltd., Corona and Maione*³⁸ held that the “ordinary dictionary meaning of ‘acquiesce’ is ‘to accept or consent quietly without protesting.’”³⁹ The court in *R. v. Solano*⁴⁰ again agreed with the interpretation as set out in *Tax Evasion in Canada*,⁴¹ from which the court quoted with approval as follows:⁴²

The concept of assent seems to imply something less than active participation, that is, the expression of concurrence without the necessity of taking an active role in the perpetration of the offence. Acquiescence would seem to be even further removed from the action, involving a tacit consent or perhaps a wilful blindness.

Since subsection 118.1(9) applies to receipts issued by registered charities, it follows that it contemplates an active role of the person (i.e. either the registered charity itself, or someone who is not an officer, employee, official or agent of the charity) making a false statement on a donation receipt, rather than a person who took a passive role in making the statement. Similar to the planner penalty, a penalty pursuant to subsection 188.1(9) could apply to tax shelter promoters holding seminars or presentations to provide information in respect of a specific tax

³³ *Black’s Law Dictionary*, 8th ed., s.v. “participation”.

³⁴ (1994), 163 A.R. 230 (Prov. Ct.).

³⁵ Williams I. Innes, *Tax Evasion in Canada* (Toronto: Carswell, 1987) at p. 79.

³⁶ *Supra* note 34, at paras. 10 and 11.

³⁷ *Supra* note 33, s.v. “acquiescence” and “assent”.

³⁸ (1980), 56 C.C.C. (2d) 31 (Ont. Prov. Ct. (Crim. Div.)).

³⁹ *Ibid.* at 41.

⁴⁰ *Supra* note 34.

⁴¹ *Supra* note 35.

⁴² *Supra* note 36.

shelter, and appraisers and valuers preparing a report for a proposed scheme/shelter.⁴³ It could also apply to circumstances where a donor misrepresented the amount of advantage to the charity issuing the receipt.

d) What would constitute a “statement”

Subsection 188.1(9) provides that the penalty only applies to false statements contained “on a receipt issued ... for the purposes of subsection 110.1(2) or 118.1(2).” Subsections 110.1(2) and 118.1(2) provides that corporations and an individual may not deduct an amount in respect of a gift unless the gift is evidenced by a receipt containing information prescribed in Regulations 3501(1), (1.1) and (6).

This is different from the third-party civil penalty that could result from a statement which includes “oral and written communications or assertions.”⁴⁴ However, CRA specifically clarified that a “statement” for purposes of the third-party civil penalty includes “donation receipts.”⁴⁵

e) Meaning of “false statement”

Subsection 188.1(9) provides that the meaning of “false statement” is the same as the meaning assigned by subsection 163.2(1) of the Act. Subsection 163.2(1) defines a “false statement” as “includ[ing] a statement that is misleading because of an omission from the statement.” The definition for “false statement” uses the word “includes” rather than the word “means.” This indicates that the ordinary and natural meaning of the word would apply. In this regard, the court in *Storrow v. Her Majesty the Queen*⁴⁶ reviewed the meaning of “moving expenses” in subsection 62(3) of the Act. The court held that “where a definition uses the words ‘includes,’ ... then the expression said to be defined includes not only those things declared to be included, but such other things ‘... as the word signifies according to its natural import.’”⁴⁷ Therefore, the court held that the words “moving expenses” must be “construed in their ordinary and natural sense in their context in the particular statute.”

The meaning of “false statement” in subsection 163.2(1), as it applies to a third-party

⁴³ *Supra* note 30.

⁴⁴ *Supra* note 32 at 1760.

⁴⁵ *Supra* note 26 at 23.

⁴⁶ 1978 CarswellNat 253, [1978] C.T.C. 792, 78 D.T.C. 6651, [1979] F.C. 595 (T.D) [cited to CarswellNat].

⁴⁷ *Ibid.* at para. 10.

civil penalty, is clarified in CRA's Information Circular IC 01-1.⁴⁸ It states that a false statement is "an incorrect statement, including a statement that is misleading because of an omission from the statement, regardless of whether the person making, participating in, or assenting to the making of, the statement has any intention to deceive."⁴⁹ CRA further clarified that a false statement would not include a statement made as a result of "an honest error."⁵⁰

f) Culpable conduct

Subsection 188.1(9) provides that in order for the penalty to apply, the statement must be one "that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct (within the meaning assigned by subsection 163.2(1)), is a false statement." It has been pointed out that "whether a person knows something is a question of fact" and "in most cases, whether the professional knows that a statement is false will be determined on the evidence on the balance of probabilities test applicable to civil actions."⁵¹

"Culpable conduct" is defined in subsection 163.2(1) as follows:

- "culpable conduct" means conduct, whether an act or a failure to act, that
- (a) is tantamount to intentional conduct;
 - (b) shows an indifference as to whether this Act is complied with; or
 - (c) shows a wilful, reckless or wanton disregard of the law.

CRA explained the following in relation to the requirement of "culpable conduct":⁵²

"Culpable conduct" must be present in the absence of actual knowledge of a false statement ... Culpable conduct refers to conduct that is *not simply an honest error of judgment or failure to exercise reasonable care (i.e. ordinary negligence)*. ... [T]he concept "culpable conduct" is defined with reference to the types of conduct to which the courts have considered applying in a civil penalty under the tax law (i.e. *criteria considered for subsection 163(2) gross negligence penalty in the case of Lucien Venne v. Her Majesty the Queen ...*). [emphasis added]

The "culpable conduct" requirement is a legislated version of the criteria considered for subsection 163(2) of the Act, which imposes an administrative "gross negligence" penalty on a taxpayer who "knowingly, or under circumstances amounting to gross negligence, has made or

⁴⁸ *Supra* note 26.

⁴⁹ *Ibid.* at para. 22.

⁵⁰ *Ibid.*

⁵¹ *Supra* note 32 at 1764.

⁵² *Supra* note 49 at para. 24.

has participated in, assented to or acquiesced in the making of, a false statement or omission” for purposes of the Act. In this regard, the court in *Lucien Venne v. Her Majesty the Queen*,⁵³ when deciding whether to impose a penalty under subsection 163(2) of the Act, held as follows:⁵⁴

“Gross negligence” must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.

Furthermore, in 2000, the court in *897366 Ontario Ltd. v. Canada*⁵⁵ held that the imposition of a penalty under section 285 of the *Excise Tax Act*, which contains substantially similar wording to subsection 163(2), “requires a serious and deliberate consideration by the taxing authority on the taxpayer’s conduct to determine whether it demonstrates a degree of wilfulness or gross negligence justifying the penalty ... the penalties may only be imposed under section 285 in the clearest of cases, and after an assiduous scrutiny of the evidence.”⁵⁶ Therefore, “culpable conduct” could be present under any one of the three circumstances included in the definition for “culpable conduct,” each of these circumstances is reviewed below.

i) Tantamount to intentional conduct

CRA explains that the expression “tantamount to intentional conduct” means “conduct that is equal, in effect, to intentional conduct, i.e. a person’s conduct (an act or failure to act) shows that the person must have intended to make (or participate in or assent to the making of) a false statement.”⁵⁷

In relation to subsection 163.2 third-party civil penalties, CRA indicated that examples of conduct that would be tantamount to intentional conduct would include deliberate over-valuation in a tax shelter-like arrangement, and deliberate over-valuation in an abusive tax shelter. These examples would also be applicable to the imposition of an intermediate penalty for false statements if such conduct lead to the over-statement of the value of property donated to a charity.

⁵³ 1984 CarswellNat 210, [1984] C.T.C. 223, 84 D.T.C. 6247 (F.C.T.D.)

⁵⁴ *Ibid* at para. 37.

⁵⁵ [2000] T.C.J. No. 117, [2000] G.S.T.C. 13 (T.C.C.).

⁵⁶ *Ibid.* at para. 19 See also *Drozdzik v. Canada*, [2003] 2 C.T.C. 2183 (T.C.C.), where the court made the following comment at para. 290 about imposing a penalty under subsection 163(2) of the Act:

This is a penal section. It has extreme consequences for the taxpayer and should only be resorted to on evidence which makes it clear that the taxpayer has knowingly, or under circumstances amounting to gross negligence, made an omission or false statement in his returns of income which resulted in him reporting less tax than he would otherwise have had to pay.

⁵⁷ *Supra* note 48 at para. 25.

ii) Indifference

CRA explains that the expression “shows an indifference as to whether this Act is complied with” describes the passive aspect of culpable conduct. CRA further explains as follows:⁵⁸

The expression means that the person’s actions or failure to act indicates that the person was wilfully blind regarding the facts or the application of the tax legislation. The person suspects that the situation demands that certain questions be asked. However, inquiries are not made because the person would then possess the knowledge of the false statement.

The court in *Sirois (L.C.) v. Canada*,⁵⁹ in finding the taxpayer acted with gross negligence within the meaning of subsection 163(2) of the Act because he “showed an indifference as to whether the Act was complied with or not” and suggested that “he buried his head in the sand.”⁶⁰ CRA explained that the “indifference standard” is considered to be “much more than that of ordinary negligence,” and that “it is more or less than equivalent to the standard used to measure the purposeful act of wilful, reckless or wanton disregard of the law.”⁶¹ In *Gerald Malleck v. Her Majesty the Queen*,⁶² the court held that within the meaning of subsection 163(2), “there is ... little, if any, difference between approaching ‘the wilful, the reckless, the wanton’ and ‘indifference as to whether the law is complied with or not.’”⁶³

iii) Wilful, reckless, or wanton disregard of the law

CRA explains that the expression “shows a wilful, reckless or wanton disregard of the law” “points to the situation where a reasonable prudent person would know that it is highly likely that a false statement could be made but purposefully continues with the chosen course of action.”⁶⁴

It has been pointed out that “the standard of ‘wilful, reckless or wanton disregard of the law’ ... will be construed by the courts as involving something more than gross negligence” and that “in order to meet this standard, there must be conduct ‘more reprehensible’ than gross

⁵⁸ *Ibid.* at para. 26.

⁵⁹ 1995 CarswellNat 555, [1995] 2 C.T.C. 2684 (T.C.C.).

⁶⁰ *Ibid.* at para. 13.

⁶¹ *Supra* note 48 at para. 27.

⁶² (1997), 98 D.T.C. 1019 (T.C.C.).

⁶³ *Ibid.* at 1021.

⁶⁴ *Supra* note 48, at para. 28.

negligence, involving a subjective intent on the part of the person being penalized (and not simply a breach of an objective standard of reasonableness).”⁶⁵

After reviewing a number of cases in relation to the judicial interpretation of “gross negligence,” Bruce Russell pointed out that the “courts are not readily disposed to find either gross negligence or ‘culpable conduct,’ the substantive counterpart of gross negligence.”⁶⁶ He continued to point out that “if a national and credible explanation is provided, then that usually should suffice to avoid a finding of gross negligence or of its cousin, culpable conduct.”⁶⁷

iv) Inquiries necessary

CRA indicated in its Information Circular IC 01-1 that a taxpayer would be “indifferent” if the person “suspects that the situation demands that certain questions be asked” but nevertheless “inquiries are not made.”⁶⁸ In addition, it is necessary for inquiries to be made where it is reasonable to do so.⁶⁹

It is clear that where language such as “indifferent”, wilful” or “reckless” is used in the legislation, it will not be sufficient for the advisor to fail to ask questions where a reasonably prudent person might have thought it appropriate to do so. If a person fails to make due inquiry, and the reason no inquiry is made is that there is apprehension about the answer, this is “wilful blindness” and will be tantamount to taking the action knowingly. Case law from the Supreme Court of Canada on wilful blindness suggests a high standard of conduct will be imposed on a person who fails to make inquiry when it would be reasonable to do so.

As such, the culpable conduct standard would require a charity to make inquiries when issuing donation receipts. The making of such inquiries before issuing receipts is especially important in light of the proposed “split-receipting” rules to be included in the Act to permit a donor to receive a donation tax receipt even in situations where the donor or someone else

⁶⁵ William I. Innes and Brian J. Burke, “Adviser Penalties: How Will the Courts Construe Section 163.2?,” *Report of Proceedings of Fifty-Third Tax Conference*, 2001 Tax Conference (Toronto: Canadian Tax Foundation, 2002), 37:1-38, at 28.

⁶⁶ Bruce S. Russell, “Avoiding Evasion: Tax Advisers’ Professional Responsibilities,” *Report of Proceedings of Fifty-Sixth Tax Conference*, 2004 Tax Conference (Toronto: Canadian Tax Foundation, 2005), 35:1-10 at 8.

⁶⁷ *Ibid.*

⁶⁸ *Supra* note 58.

⁶⁹ Douglas H. Matthew, “Judicial Approaches to Third-Party Civil Advisor Penalties,” *2001 British Columbia Tax Conference* (Vancouver: Canadian Tax Foundation, 2001), 17:1-29 at 6.

received an advantage as a result of the gift.⁷⁰ However, it remains to be seen what level of inquiries will be required to be made by charities.

It is hoped that CRA will provide the charitable sector with administrative guidelines on the type of due diligence that would be required of charities when issuing split-receipts in this regard, such as what indicia charities would need to be aware of in order to determine when to request information from donors, what type of information to request, how to document the requests made and information received from donors, and what steps to take when donors are not cooperative in providing information.⁷¹

g) Good faith defences not available

Subsection 163.2(6) provides a “good faith” defence for an advisor if the person relied in good faith on information provided to the advisor by, or on behalf of the taxpayer, or because of such reliance, failed to verify, investigate, or correct the information. This defence is not available to an advisor who is involved in an “excluded activity,” i.e. the promotion or sale of arrangements or accepting consideration for the same.

This defence, however, is not applicable to a subsection 188.1(9) intermediate penalty. It therefore would appear that a tax advisor could rely on the good faith defence with respect to a false statement made on a receipt in relation to his/her exposure to the third-party civil penalty, but would not be able to rely on such a defence with respect to the same false statement on the receipt in relation to his/her exposure to the intermediate penalty pursuant to subsection 188.1(9).

h) Penalty

Subsection 188.1(9) of the Act imposes a penalty equal to 125% of the amount shown on a receipt if it contains a false statement. Paragraph 188.2(1)(c) provides that if the total penalty pursuant to subsection 188.1(9) for a taxation year exceeds \$25,000, then the registered charity’s tax-receipting privileges shall also be suspended for one year. The penalty remains the same upon repeat infractions of the same offence by a charity.

If the Ministry decides to suspend the tax-receipting privilege of a registered charity pursuant to subsection 188.2(1), the Minister will give notice to the charity by registered mail and the suspension will take effect seven days after the mailing of the said notice and assessment

⁷⁰ *Supra* note 24. See also Theresa L.M. Man and Terrance S. Carter, “Inquiries Still Required When Charities Issue Donation Receipts” *Charity Law Bulletin* No. 82 (11 January 2006) (online: www.charitylaw.ca).

⁷¹ *Ibid.*

by the Minister. Paragraph 188.2(3)(a) provides that the issuance of the assessment notice by the Minister would have the effect of deeming the registered charity in question not to be a qualified donee for purposes of the Act during the said one year period. In addition, paragraph 188.2(3)(b) provides that if the registered charity is offered a gift during the said one-year period, then, before accepting the gift, the charity must inform the donor that (1) the charity has received the said assessment notice from the Minister, (2) no charitable deduction or credit may be claimed by the donor, and (3) the gift made is not a gift made to a qualified donee.

Subsection 188.2(4) provides that the registered charity in question may, after having filed a notice of objection to a suspension, file an application with the Tax Court of Canada for a postponement of that portion of the period of suspension that has not elapsed until the time determined by the Court. Subsection 188.2(5) provides that the Court may grant such an application if it would be “just and equitable” to do so.

From a practical standpoint for donors, although registered charities whose tax-receipting privilege has been suspended must advise donors of the same under paragraph 188.2(3)(b), it would be helpful for CRA to publish on its website a list of all registered charities whose tax-receipting privilege has been suspended in order to avoid donors making donations to these entities.

i) Avoiding the penalty

Subsection 189(6.3) provides that if a charity is assessed intermediate penalties under section 188.1 in an amount over \$1,000 for a taxation year, the amount of penalties could be reduced by the value of property transferred by the charity to an “eligible donee” in the one-year period following the assessment date. However, if the charity receives consideration from the eligible donee for the property transferred, the value of the consideration received will be deducted from the value of the property transferred and would not be applied towards reducing the penalty liability.

Subsection 188(1.3) provides that an “eligible donee” is a registered charity whose ability to issue official donation receipts is not under suspension, does not have unpaid liabilities under the Act or under the *Excise Tax Act*, has filed all information returns required by subsection 149.1(14), is not subject to a certificate under the *Charities Registration (Security Information) Act*, and with more than 50% of its directors or trustees dealing at arm’s length with each member of the board of directors or trustees of the charity in question.

The Charities Directorate of CRA has expressed that the rationale of this provision is that their focus is not on the collection of revenue but enforcing a regime that allows charitable giving. Therefore, they would prefer to “keep the money in the charitable sector and reapply that money to other charities.”⁷²

From a practical standpoint, since CRA does not provide a list of registered charities that qualify as eligible donees, it would be difficult for the revoked charity to determine if the transferee is an eligible donee. As such, unless information is published by CRA in this regard, the revoked charity would need to exercise diligence in determining this information either by obtaining confirmation from CRA or by obtaining assurance from the transferee registered charity.

E. Conclusion

The implementation of intermediate penalties on receipts by registered charities not in compliance with the Act or the Regulation in relation to the issuance of charitable donation receipts is a welcome change. This is especially the case where non-compliant receipts are issued as a result of advertence. Since the implementation of intermediate penalties on May 13, 2005, there has not been any case law on how these provisions would be applied or interpreted by the courts. It remains to be seen how these provisions will be applied by CRA or interpreted by the courts.

⁷² Elizabeth Tromp, “The Charities Directorate and the Regulatory Reform Initiative,” *Report of Proceedings of Fifty-Sixth Tax Conference*, 2004 Tax Conference (Toronto: Canadian Tax Foundation, 2005), 9:1-6.