
CHANGES TO SANCTIONS, PENALTIES AND APPEALS PROCESS FOR CHARITIES

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A. INTRODUCTION

Bill C-33, *A second Act to implement certain provisions of the budget tabled in Parliament on March 23, 2004*, (“Bill C-33”) received Royal Assent on May 13, 2005 and is now in force with a new regulatory regime for charities. Amendments to the *Income Tax Act* (the “Act”) in Bill C-33 implement new rules concerning the taxation and administration of charities originally set out in the 2004 Federal Budget. The new rules generally apply to taxation years beginning after March 22, 2004, with some exceptions being in effect 30 days after Royal Assent, and include a more accessible appeals regime, new intermediate sanctions, improved transparency and more accessible information, as well as new disbursement quota rules for charities. This *Charity Law Bulletin* will outline the new penalties and sanctions now available to Canada Revenue Agency (CRA) in the administration of charities, as well as the new appeals process, and the resulting implications for charities.¹

B. NEW INTERMEDIATE SANCTIONS

Prior to the 2004 Federal Budget, the only sanction available to the CRA in regulating registered charities was the revocation of a charity’s registration. Quite often revocation occurred inadvertently as a result of a failure by the charity to file an information return or because the charity was being discontinued. It was invoked only rarely by CRA in situations of serious non-compliance and only after a lengthy audit process.

¹ Changes to the disbursement quota were previously discussed in *Charity Law Bulletin* Nos. 67 and 69 available at www.charitylaw.ca.

Further, a registered charity which had had its registration revoked had one year to divest itself of its assets to other registered charities or qualified donees in order to avoid the revocation tax, essentially the transfer of any remaining assets to the Crown.

1. New Sanctions and Penalties

To provide an alternative to the revocation of charitable status for minor or unintended infractions, the Act now provides for intermediate sanctions. In the situation of a failure to file an information return on time, the registered charity will be subject to a monetary penalty of \$500.² A registered charity may also face a suspension of its ability to issue tax-receipts and to receive funds from other charities for one year if it fails to comply with certain verification and enforcement provisions of the Act (eg. fails to keep proper books and records).³ Private foundations, public foundations and charitable organizations which carry on certain business activities will be subject to a monetary penalty equal to 5% of their gross revenue from such business activities. A repeat offence within 5 years of the first infraction will carry a monetary penalty equal to all of the charity's gross revenue from the offending activities as well as a suspension of its ability to issue tax receipts.⁴

Similarly graduated monetary penalties will be applied to registered charities if

- ◆ a charitable foundation acquires control of a corporation;
- ◆ a registered charity confers on a person an undue benefit (essentially, transfers resources of the charity for the personal benefit of a member, director or trustee of the charity which could include excessive salaries or Board compensation);
- ◆ a registered charity issues improper receipts;
- ◆ a person provides false information for the purposes of a tax-receipt, which could include incorrect valuation information of either the property gifted or the advantage received by the donor when making the donation; or if
- ◆ a registered charity makes a transfer to another registered charity for the purpose of delaying expenditures on charitable activities.

In addition, if a charitable foundation acquires control of a corporation a second time within the span of 5 years, if false information has been provided and the amount of the penalty imposed is in excess of \$25,000, or if a charity has received a gift and issued a receipt on behalf of a registered charity under

² Subsection 188.1(6).

³ Subsection 188.2(2).

⁴ Subsections 188.1(1), 188.1(2), and 188.2(1).

suspension the registered charity will also face suspension of its ability to issue tax receipts and to receive funds from other charities for one year.⁵

The following table sets out the various infractions now established in the Act and the graduated penalties which may be applied:

Offence	First Infraction	Repeated Infraction (Within 5 years)
<ul style="list-style-type: none"> • Late filing or failure to file T3010A • Issuing incomplete receipts • Carrying on prohibited business activity <ul style="list-style-type: none"> • Private foundation - any business • Public foundation or charitable organization - unrelated business • Charitable foundation acquiring control of corporation • Failure to comply with certain verification and enforcement requirements (e.g. keeping proper books and records) • Issuing receipts in taxation year if there is no gift or if receipt contains false information • Transfer among charities to avoid disbursements quota (joint and several liability with recipient charity) • Undue personal benefit 	<ul style="list-style-type: none"> • \$500 penalty • Penalty of 5% of eligible amount stated on receipt • Penalty of 5% of gross revenue from the offending activity • 5% penalty on dividends received from corporation • Suspension of tax receipting privileges for one year • 125% penalty on eligible amount of receipts (suspension of tax receipting privilege if total penalties under 188.1(9) exceeds \$25,000 in a taxation year) • Penalty of 110% of amount transferred • Penalty of 105% of benefit 	<ul style="list-style-type: none"> • \$500 penalty. • May lead to revocation • Penalty of 10% of eligible amount stated on receipt • Penalty of 100% of gross revenue from the offending activity and suspension of receipt privileges for one year • 100% penalty on dividends received from corporation • Suspension of tax receipting privileges for one year • 125% penalty on eligible amount of receipts (suspension of tax receipting privilege if total penalties under 188.1(9) exceeds \$25,000 in a taxation year) • Penalty of 110% of amount transferred • Penalty of 110% of benefit and suspension of tax receipt privileges for one year

⁵ Subsection 188.2(1).

2. Annulment and Revocation

The Act now provides CRA with explicit authority to annul an organization's registration if it was registered in error or if it has ceased to be a charity "solely as a result of a change in law." Annulled organizations will be deemed not to have been registered at all and the Part V revocation tax will not apply, but official receipts issued prior to annulment will be accepted as valid.⁶ CRA retains the right to revoke the registration of a charity in the event of severe breaches of the Act.

3. Other Changes to Penalties and Sanctions

Both monetary penalties imposed as part of the intermediate sanctions and the revocation tax may now be reduced by any amounts transferred to an eligible donee, which essentially are compliant registered charities.⁷

C. NEW APPEALS PROCESS AND TAX COURT TIPS

1. Centralized internal appeals regime

Changes to the appeals regime provide registered charities with access to CRA's internal appeals process and the Tax Court of Canada, remedies familiar to tax practitioners but not necessarily to lawyers practicing in the charitable sector. The new appeals regime is intended to make the process more accessible and affordable. Previously, the only avenue for challenging CRA's decisions on charitable matters was through the Federal Court of Appeal. The amendments have extended CRA's existing internal objection review process to decisions by CRA regarding the revocation or annulment of a charity's registration, the designation of a charity as a private or public foundation or a charitable organization, the denial of applications for charitable status, suspension of tax-receipting privileges, and the imposition of monetary penalties or revocation tax against a registered charity.⁸ Filing a notice of objection is now a required step before an appeal may be brought to the Courts.

In the above-mentioned circumstances, a charity may file a notice of objection with the Assistant Commissioner of CRA's Appeals Branch within 90 days of the date of the decision's mailing (in income tax matters, objections are filed with the local Chiefs of Appeals). The notice of objection should

⁶ Subsections 149.1(23) and (24).

⁷ Subsection 188(1.3) defines "eligible donee."

⁸ Subsections 168(4) and 189(7) to (9).

identify the decision objected to, the reasons for the objection and all relevant facts. If the objection relates to a suspension of tax-receipting privileges, a charity may also apply for a postponement of the suspension to the Tax Court of Canada. The notice of objection will be reviewed by an officer in the Appeals Branch of CRA, separate from the Charities Directorate, and the officer will have the authority to maintain, vary or disagree with the original decision.

2. Tax Court

If a charity disagrees with CRA's decision resulting from an objection, appeals in respect of decisions concerning refusals to grant registered charitable status and revocation of registered charitable status will continue to be made to the Federal Court of Appeal. However, with respect to the imposition of the new monetary penalties and/or the revocation tax or suspension of its tax receipting privileges, a charity may now appeal the decision to the Tax Court of Canada under either the informal procedure (expected to apply if the amount of penalties or tax is less than \$12,000) or general procedure. The Tax Court of Canada must receive the Notice of Appeal within 90 days of the date of mailing of the decision on the objection (or after 90 days from the day of filing of a notice of objection if CRA has not yet provided a decision). In order to resolve informal procedure appeals as quickly as possible, the Tax Court does not have to follow technical rules of evidence. However, such judgments will not be treated as precedents for other cases. Appeals under the general procedure will follow the usual litigation process, including an exchange of lists of documents, examinations for discovery and trial. It is important to note that the burden of proof is generally on the appellant in procedures before the Tax Court. Lawyers for the Department of Justice, who act for CRA in such matters, will entertain settlement discussions throughout the litigation process.

D. CONCLUSION

The introduction of new intermediate sanctions and penalties are important changes for charities, providing more appropriate recourse for unintended or incidental breaches. As well, the new appeals regime is a positive step intended to make the process more accessible and affordable. However, the regulation of charities is ever increasing in scope and complexity. In addition, CRA may now release additional information to the public, including grounds for revocation or annulment; financial statements; decisions of CRA regarding notices of objection; identification of registered charities which are subject to sanctions, the type of sanction imposed as well as grounds for the sanction; information to support an application by a registered charity for special status or an exemption under the Act (e.g. request for permission to accumulate assets); and reasons for denying the registration of organizations.⁹ These changes will require careful review by charities and their advisors.

⁹ For more information refer to *Charity Law Bulletin* Nos. 76, and 77 available at www.charitylaw.ca.