

CRA'S FIRST NOTICE OF SUSPENSION UPHELD BY TAX COURT OF CANADA

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A. INTRODUCTION

In 2005, Parliament passed legislation, Bill C-33, *A second Act to implement certain provisions of the budget tabled in Parliament on March 23, 2004*, which implemented new rules concerning the taxation and administration of charities. These new rules included changes to the appeals regime, which gave the Tax Court of Canada new jurisdiction in respect of charities, and the addition of new intermediate sanctions.

As reported in the November 2007 issue of *Charity Law Update*, Canada Revenue Agency ("CRA") has now issued the first suspension of income tax receipting privileges under the new intermediate sanctions.¹ The charity whose receipting privileges were suspended, the International Charity Association Network ("ICAN"), applied to the Tax Court of Canada for a postponement of the suspension pursuant to subsection 188.1(4) of the *Income Tax Act*² (the "ITA"). In its decision, released January 3, 2008, the Court dismissed ICAN's application for a postponement of the suspension. Justice Rip, of the Tax Court of Canada, held that ICAN did not introduce any evidence from its member agencies describing how the suspension of receipting privileges would cause them harm, and that the balance of convenience favoured CRA because, if the

¹ For a detailed discussion of these new sanctions, penalties and appeals process, see *Charity Law Bulletin* No. 82 entitled "Changes to Sanctions, Penalties and Appeals Process for Charities" available at www.charitylawbulletin.ca.

² R.S.C. 1985, c. 1 (5th Supp.) [ITA].

suspension were postponed, according to the Court, CRA would be “handcuffed” in its ability to administer the charities provisions of the ITA, to ensure compliance and to protect the public interest.³

This *Charity Law Bulletin* reviews the decision, and sets out the legal principles the Court applied in analysing the facts in the case, as well as the advice the Court has given about conditions under which future cases of this nature may be decided.

B. BACKGROUND

CRA monitors registered charities’ compliance with the ITA through the audit process. The decision whether or not to issue a notice of suspension to a charity would most likely be made after CRA has completed this audit process. An audit of a registered charity will usually include an examination of the charity’s financial affairs, a review of its activities to determine whether it is operating in accordance with its charitable purposes, and an evaluation of any evidence which might indicate whether or not it is satisfying its legal obligations under the ITA.⁴

ICAN is a not-for-profit corporation incorporated under the provisions of the *Corporations Act* (Ontario). It was granted registered charity status by CRA effective August 17, 2000. CRA issued a Notice of Suspension to ICAN on November 21, 2007, pursuant to its authority under subsection 188.2(2) of the ITA, on the grounds that ICAN failed to maintain books and records, and failed to provide records or to provide access to records to CRA, contrary to subsections 230(2), 231.1(1) and 231.2(1) of the ITA⁵ (the “Notice of Suspension”). The suspension is for one year, the maximum period allowed under subsection 188.2(2), commencing on November 28, 2007. During this period, ICAN is prohibited from issuing official income tax receipts for donations made to it, but has not been precluded from carrying out its charitable activities.

ICAN filed a Notice of Objection to the Notice of Suspension with CRA on November 23, 2007 declaring that

it at all times attempted to comply with requests by the CRA to provide information and to make its books and records available to CRA representatives. ICAN says it responded to questions by the CRA and submitted its records for review. The

³ *International Charity Association Network v. Canada*, [2008] T.C.J. No. 1; 2008 TCC 3, para. 78..

⁴ See *Charity Law Bulletin* 117 entitled “Guidelines for Applying the New Intermediate Sanctions for Charities,” available at www.charitylawbulletin.ca for a detailed discussion of CRA’s guidelines for the application of intermediate sanctions.

⁵ *ICAN*, *supra* note 3 at para. 2.

applicant [ICAN] also claims it allowed the CRA to remove certain of its records for review.⁶

In an affidavit submitted to the Court on behalf of ICAN, its charitable activities were described as follows:

8. The Applicant raises funds and receives donations-in-kind of food, household goods and other items including educational materials and licenses for the use of educational software programs (the “Courseware”) for use directly in the charitable activities it carries on and for distribution to other organizations for use in their charitable activities.

9. ICAN has 16 employees across Canada, only 3 of whom deal with the office administration. These 3 employees were the personnel at ICAN that had to deal with all the requests for information from the CRA that have been received by ICAN during the past year.

10. There are currently 367 agencies or organizations that receive such goods from the Applicant and are dependant on the Applicant in order to continue to carry on their activities.

11. The Applicant operates as an “umbrella organization” for other charities, soliciting, purchasing and collecting donated items in bulk and distributing the items in smaller quantities to ICAN Member Agencies. The Applicant also operates internet based information exchange facilities to assist ICAN Member Agencies in operating their own programs and communicating their information and requirements for assistance to other ICAN Member Agencies.

12. The ICAN Member Agencies include churches that operate food banks, schools and other organizations that operate breakfast and snack programs for children, hostels and shelters for the homeless, and organizations that run youth programs in troubled neighbourhoods. The Courseware is distributed to computer training centres operated by ICAN as well as churches, municipalities, community centres, correctional institutes and other charitable organizations for the purpose of operating their skills and job training programs.

13. Many of the corporations who have already promised to deliver do-nations of food and household items to ICAN require receipts from ICAN in order to record the donations of inventory in their own ac-counting records. It is my understanding that while these corporations do not claim a deduction for these donations as charitable donations, the receipts are required in order to record the reduction in inventory in their accounting records.⁷

⁶ *Ibid.* at para. 4.

⁷ *Ibid.* at para. 12.

CRA, in its affidavit, stated that it conducted an audit of the operations of ICAN for the fiscal period 2001 to 2006. CRA was concerned by ICAN's participation in tax shelters, which have resulted in a significant increase of total revenue during this period: from \$528,000 in 2001 to \$314 million in 2005. CRA's concerns also related to the valuation and existence of gifts in kind, which comprised the majority of ICAN's donations, and whether or not ICAN actually received the goods for which it issued income tax receipts.⁸ CRA also questioned whether the activities ICAN was carrying out were consistent with its objects as set out in its Letters Patent. The affidavit describes the discrepancies as follows:

- a) Minimal information was provided by the applicant regarding the applicant's operation of community computer centres.
- b) The applicant does not conduct any activities to relieve poverty in developing nations.
- c) The applicant does not develop training and education programs for needy persons.
- d) Despite having reported in its information returns that it provides counselling and other similar services to shelters, charities and non-profit organizations, the applicant has not supplied counselling services to these entities.
- e) Although the applicant reports operating over 50 community computer centres across Canada, little or no details were provided to the CRA to support that the applicant actually maintains or operates the centres or that the services provided, if any, are limited to needy persons.
- f) Of the activities which we could confirm, the information provided was wholly inconsistent with the volume of activity being reported: the support of 367 member agencies, the operation of 50 community computer centres, \$244 million in expenditures in 2005 and serving over 20,000,000 meals. The information provided by the applicant did not support this volume of activity.⁹

CRA further alleges that ICAN has not provided sufficient evidence of its income and expenditures, nor has it provided evidence of the valuations of the gifts in kind that it states were valued by professionals in the industry.¹⁰

⁸ *Ibid.* at paras. 37; 39.

⁹ *Ibid.* at para. 40.

¹⁰ *Ibid.* at para. 69.

C. SUMMARY OF DECISION

As noted above, ICAN filed a Notice of Objection to the Notice of Suspension and applied to the Tax Court of Canada for an order postponing the suspension pursuant to subsection 188.2(4) of the ITA. Subsection 188.2(4) provides that a charity may file an application to the Tax Court of Canada for a postponement of that portion of the period of suspension that has not elapsed if a Notice of Objection to the suspension has been filed with CRA.¹¹ Subsection 188.2(5) gives the Tax Court of Canada the authority to grant an application for postponement “only if it would be just and equitable to do so.”¹²

In determining what was the appropriate legal test to apply in the circumstances, the Court found that the authority given it under subsection 188.2(5) is essentially the same as a statutory injunction,¹³ and relied on the Supreme Court of Canada decision in *Manitoba (A.G.) v. Metropolitan Stores (MTS) Ltd.*¹⁴ (“*Metropolitan Stores*”) as authority supporting the application of the legal test for granting an injunction to an application for postponement of a Notice of Suspension pursuant to subsection 188.2(4) of the ITA. That test, as enunciated in *RJR-MacDonald Inc. v. Canada (A.G.)*¹⁵ (“*RJR-MacDonald*”), is as follows: the applicant must establish that (i) there is a serious question to be tried; (ii) irreparable harm will result if the injunction is not granted; and (iii) the balance of convenience favours an injunction.¹⁶

The Tax Court proceeded with the application of the three-part test to the facts set out in the supporting affidavits as follows:

1. Serious Question to be Tried

CRA argued that ICAN did not have a serious issue to be tried because, among other reasons, ICAN acknowledged in a letter to CRA that it does not maintain invoices and detailed computations supporting its fundraising fees; it does not maintain a record of the recipients or use of courseware it claims to have distributed in 2005; and CRA’s audit raised questions about whether or not the amounts entered on the income tax receipts equalled the value of the gifts.¹⁷ ICAN argued that it had maintained

¹¹ *ITA*, *supra* note 2, ss. 188.2(4).

¹² *Ibid.*, ss. 188.2(5).

¹³ *ICAN*, *supra* note 3 at para. 6.

¹⁴ *Manitoba (AG) v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 [*Metropolitan Stores*].

¹⁵ [1994] 1 S.C.R. 311 [*RJR-MacDonald*] [QL].

¹⁶ *ICAN*, *supra* note 3 at para. 8.

¹⁷ *ICAN*, *supra* note 3 at para. 59.

proper books and records based on “it’s understanding” of the CRA requirements.¹⁸ Justice Rip found that there was a serious issue to be tried for the following reason: even though a registered charity must comply with the statutory requirements granting its status, “[a] charity’s ability to issue receipts to donors for income tax purposes is its lifeblood. Prohibiting ICAN from issuing receipts for a year will probably affect its activities.”¹⁹ However, the Court also issued a strong warning that charities must comply with their statutory obligations and that the “quality, quantity or nature of charitable activities ... do not trump the requirements of the Act.”²⁰

2. Irreparable Harm

The applicant had the onus to prove irreparable harm and the Court found that, while ICAN argued that its member agencies would suffer irreparable harm if the suspension were not postponed, it presented no evidence from those member agencies to support this argument. Justice Rip stated that,

[u]nfortunately, the applicant introduced no evidence from its member agencies describing how the suspension of receipting privileges would affect them I do not know, for example, how much any agency depends on ICAN to operate. Is ICAN’s contribution to an agency modest or substantial? What proportion of the agency’s income comes from ICAN? In other words, what is the significance of ICAN’s contribution to any one agency? ICAN has not met the burden of proof incumbent on it to demonstrate irreparable harm on its side.²¹

The Court also found that the limited office staff employed by ICAN, despite handling over half a billion dollars, demonstrated that ICAN did not make the maintenance of its books and records a priority.²²

On the other hand, the Court was “disturbed” by CRA’s description of the amounts of income collected by ICAN and its disbursements to another organization, and receipts given for certificates for a medical scan. The Court noted that CRA had alleged that the income tax receipts ICAN issued for gifts of courseware were three times the value of the original gifts, and that, despite ICAN’s claim that the gifts had been valued by professionals, no valuations were submitted to the Court, which normally could

¹⁸ *Ibid.* at para. 60.

¹⁹ *Ibid.* at para. 61-62.

²⁰ *Ibid.*

²¹ *ICAN*, *supra* note 3 at paras. 67-68.

²² *Ibid.* at para 70.

have been made available fairly easily. The Court also considered that CRA had stated that it has been, or is in the process of, auditing over 30,000 taxpayers who made donations to ICAN. Finally, Justice Rip found that, despite ICAN's assertion that only the interests of the parties to the application should be considered, the public interest is an important consideration in this context.²³

Thus, ICAN, who had the onus of proving irreparable harm, was unable to convince the Court that in fact it would suffer irreparable harm if the suspension were not postponed.

3. Balance of Convenience

The balance of convenience test compares which party would suffer greater harm if the injunction were granted or refused.²⁴ And, because CRA is a public authority, the Court found that harm to public confidence in CRA was a relevant consideration and should be taken into account, along with the interests of the charity. The Court quoted the following statement from *RJR-MacDonald*:

... In the case of a public authority, the onus of demonstrating irreparable harm to the public interest is less than that of a private applicant. This is partly a function of the nature of the public authority and partly a function of the action sought to be enjoined. The test will nearly always be satisfied simply upon proof that the authority is charged with the duty of promoting or protecting the public interest and upon some indication that the impugned legislation, regulation, or activity was undertaken pursuant to that responsibility. Once these minimal requirements have been met, the court should in most cases assume that irreparable harm to the public interest would result from the restraint of that action.²⁵

The Court explained that "... while the respondent [CRA] is not a regulator of charities *per se*, the Act charges the CRA with the responsibility of protecting the public interest by ensuring the compliance of registered charitable organizations with the Act."²⁶ Justice Rip went on to explain that the CRA acts in the interests of the public by ensuring compliance with the ITA, and, by doing so, it protects the public's confidence in the charitable sector, as well as potential donors.²⁷

²³ *Ibid.* at para. 66; 69.

²⁴ *Metropolitan Stores*, *supra* note 14 at 129.

²⁵ *RJR-MacDonald*, *supra* note 17 at para. 71.

²⁶ *ICAN*, *supra* note 3 at para. 76.

²⁷ *Ibid.* at para. 77.

The Court found the balance of convenience favoured CRA, and that to “postpone the suspension in the circumstances would handcuff the CRA’s capacity to administer the charities’ provisions of the Act, to ensure compliance and protect public interest.”²⁸ This finding seems to be based upon CRA’s statement that it intends to audit all donations made to ICAN, and that, if the suspension were postponed, future potential donors to ICAN could be put at risk because their donations would likely be the subject of a CRA audit and could be disallowed.

D. COMMENTARY

As the first decision with respect to the application of CRA’s new intermediate sanctions and the Tax Court of Canada’s first foray into the regulation of charities, this case is instructive on a number of issues. It clearly establishes that, from the Tax Court of Canada’s perspective, the test for applications pursuant to subsections 188.2(4) and (5) is the same as that for seeking injunctive relief. The threshold for the first part of the test – serious issue to be tried – seems to have been set fairly low and was easily satisfied by the applicant in this instance. The application of the second part of the test – irreparable harm – indicates that the Court will be looking for corroborating evidence from the charity to support any claim of irreparable harm. Finally, it appears that the third part of the test – balance of convenience – will generally favour CRA, given its role in regulating charities and protecting the public interest.

The decision also highlights the importance of maintaining adequate books and records, and notes that CRA is entitled access to invoices, receipts, vouchers, valuation reports, and any other documents that permit CRA to verify a charity’s income and disbursements. It is evident from CRA’s submissions that its’ main concern with ICAN is, not the adequacy of its books and records, but its participation in various donation tax shelters. However, rather than deal with this issue directly, CRA has chosen to suspend the charity’s receipting privileges on the basis of the inadequacy of the organization’s books and records. The difficulty for charities in the face of such a tactic is in determining what constitutes adequate books and records. The list of what CRA will require on an audit is long and detailed. Charities seeking to avoid problems during an audit should become familiar with the books and records CRA requires, as well as the various mandated retention periods.

Finally, in *obiter dictum*, the Tax Court noted that a temporary suspension under section 188.2 of the ITA is very different from revocation of charitable status pursuant to section 168 of the ITA. The Court stated that during the period of suspension, it is possible for a charity to put its books and records in order, and it is

²⁸ *Ibid.* at para. 78.

possible for the charity to resume its charitable activities. But, Justice Rip cautioned that a charity seeking to have receipting privileges restored faces a lengthy process that may not be concluded before the suspension period ends. He suggested that Parliament may wish to modify the provisions of the ITA to allow a charity to contest a suspension by a summary procedure.²⁹

²⁹ *Ibid.* at “Note”.