CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

CHARITY LAW BULLETIN NO. 313

MAY 30, 2013

EDITOR: TERRANCE S. CARTER

FEDERAL COURT OF APPEAL DECISION IN PRESCIENT

*By Karen J. Cooper**

A. INTRODUCTION

The Federal Court of Appeal recently released its decision in *Prescient Foundation v. Minister of National Revenue*,[1] an appeal by Prescient Foundation (the "Foundation") of the revocation of its charitable registration by the Minister. This decision is significant for the charitable sector as the Federal Court of Appeal addressed the long-standing inconsistencies between Canada Revenue Agency ("CRA") policy and applicable legislation on the issue of gifts to foreign charities and the reasonableness of revocation for inadequate books and records in the face of a "vague" legislation provision.

B. FACTS

The Prescient Foundation was incorporated on March 18, 2004, and was registered as a charity on May 19, 2004. The Foundation was designated a charitable public foundation and was determined to be exempt from income tax in accordance with paragraph 149(1)(f) of the *Income Tax Act*[2](the "Act"). Pursuant to an audit by CRA in 2008, the CRA issued a notice of intention to revoke the Foundation's charitable registration on December 23, 2010, based on three key issues.

* Karen J. Cooper, LL.B., LL.L., TEP, is a partner at Carters Professional Corporation practicing charity and not-for-profit law with an emphasis on tax issues and would like to thank Tanya L. Carlton, OCT, B.Sc. (Hons.), B.Ed., J.D., Student-At-Law, for her assistance in the preparation of this *Bulletin*.

[1] *Prescient Foundation v Minister of National Revenue*, 2013 FCA 120.

[2] R.S.C. 1985, ch. C-1 (5th Supp.).

1. Donation to DATA Foundation

In December 2005, the Foundation donated $500,000 to the DATA Foundation ("DATA"), a non-profit organization resident in the United States whose principal mission is to alleviate poverty and illness in Africa and recognized by the American authorities as exempt from taxation pursuant to section 501(c)(3) of the U.S. *Internal Revenue Code*, U.S.C. 26. CRA concluded that the gift to DATA was a gift to a non-qualified donee and that this justified revocation of the Foundation's charitable registration.

2. Inadequate Books and Records

The notice of confirmation of revocation issued on June 4, 2012, stated that the Foundation had "failed to maintain adequate books and records."[3] The notice of intention to revoke issued in 2010 had indicated that the Foundation only provided the CRA auditor with several relevant documents well after the initial on-site audit review and after the results of the audit had been disclosed to the Foundation.[4] CRA's view was that this did not meet the requirements of section 230 of the Act and that the Foundation had contravened this section by not allowing CRA to verify the information contained in the Foundation's financial statements and registered charity information returns.

3. Farm Sale Transactions

In February and March of 2005, the Foundation was involved in a series of transactions in relation to the sale of a farm in British Columbia which involved other charities and private third parties (the "Farm Sale Transactions"). The Farm Sale Transactions involved a complicated set of financial transactions which were used to facilitate the sale of farm assets from one individual to another. Through the use of the special tax privileges of the Foundation and other charities, the specific individuals and corporations involved were able to route proceeds of the sale on a tax-free basis. Following an audit of the Foundation, the Minister revoked the Foundation's charitable registration on the ground that the Farm Sale Transactions "were part of a tax planning arrangement for the private benefit of certain taxpayers."[5] Furthermore, the Minister determined that as part of the transactions a

[3] *Supra* note 1 at para 43.
[4] *Ibid* at para 44.
[5] *Ibid* at para 5.

$574,000 purchase of shares occurred by the Foundation which constituted a non-charitable gift to a non-qualified donee.

C. DISCUSSION

1. Donation to DATA Foundation

The Foundation submitted to the Court that the Minister erred in concluding the $500,000 gift to DATA was a gift to a non-qualified donee as DATA qualified as a registered charity pursuant to Article XXI of the Convention between Canada and the U.S. As an alternative argument, the Foundation also submitted that even if the gift was not made to a "qualified donee" pursuant to the Convention, it was still a charitable gift that should not give rise to revocation. It is this second submission that the Court addressed in its findings.

In determining whether the gift to DATA was valid charitable gift, the Court examined subsection 149.1(1) of the Act, which currently states that "charitable purposes" "includes the disbursement of funds to a qualified donee". After analyzing the word "includes" the Court stated that "'includes' clearly indicates that charitable purposes recognized under the Act extend beyond disbursements to qualified donees."[6] In order to determine whether a gift to a foreign charity was a charitable purpose or activity, the Court examined relevant common law (*Levy Estate* (*Re*) and *Wolfe Settlement*)[7] in view of the fact that the Act does not define the concept of charitable purpose or activity.

In *Levy*, the court held that a gift to a foreign charity was a charitable purpose under the common law and in *Wolfe Settlement* CRA confirmed that insofar as its disbursement quota was met, a private foundation "could make disbursements to non-qualified donees which meet the definition of 'charitable' at common law until such time as contemplated legislative amendments were adopted prohibiting such disbursements."[8] In this situation, amendments to the Act have been proposed to allow the Minister to revoke an organization's charitable registration if the organization made a gift to a foreign non-qualified donee after December 20, 2002. However, the Court noted that the legislative amendments were not in force when the Foundation made its gift to DATA, nor are they in force at

[6] *Supra* note 1 at para 25.
[7] See *Levy Estate (Re)*(1989), 68 OR (2d) 385 (Ont CA) and the settlement proceedings of *Wolfe and Millie Goodman Foundation* in Ontario Superior Court of Justice file 08-06199.
[8] *Supra* note 1 at at para 28.

this time.[9] Even though CRA provides as a matter of policy and its position before the Court was that charities cannot make gifts to foreign charities that are not qualified donees, there is no legislation in place to enforce such a position. As a result, the Court held that the revocation of the Foundation's registration on this basis was unfounded.

2. Inadequate Books and Records

In regards to the Foundation's books and records, the Foundation submitted to the Court that they met the requirements of section 230 of the Act and that any deficiencies that may have occurred were insufficient to warrant the revocation of their registration. The Court examined paragraph 230(2)(a) of the Act in order to determine the reasonableness of the Minister's revocation on the ground that the Foundation had not complied with that provision.

In order for a revocation to be reasonable, the Court stated that the Minister must "(a) clearly identify the information which the registered charity has failed to keep, and (b) explain why this breach justifies the revocation of the charity's registration."[10] This is so that the Court is in a position to clearly understand the why the Minister is revoking the registration and so that the rules of natural justice apply and the registered charity is "properly and adequately informed" of the allegations and can respond in a meaningful way.[11]

On a revocation, this would usually require the "Minister's representative to transparently and intelligibly explain in the notice of intention to revoke which records and information the charity failed to keep and to make available, and why this failure should result in the revocation of its registration."[12] The Minister may also refer in court to relevant prior correspondence with a charity in which the issue of inadequate records and books was raised. The Court also stated that it did not matter who bore the initial burden of proof, but that the Court must be satisfied that it "was reasonable, in the circumstances, for the Minister to require the records or information at issue, and that the revocation of the charity's registration was a reasonable response to a failure to maintain or

[9] *Ibid* at para 29. As of May 30, 2013 the relevant sections of the ITA have yet to be amended.
[10] *Supra* note 1 at para 47.
[11] *Ibid* at para 48.
[12] *Ibid* at para 49.

provide them."[13] Given that other corrective measures or intermediate sanctions are available, the Court stated that a charity's registration should only be revoked under section 230 in "a case of material or repeated non-compliance."[14]

In the case of the Foundation, the Court found that the Foundation maintained no records of its Board of Directors meetings in regards to its involvement in the Farm Sale Transactions, did not maintain documentation that clearly showed the gift to DATA had been made to an American charity, and did not disclose relevant information to the auditor in a timely fashion. The Court held that the lack of records in regards to the Farm Sale Transactions would not, in and of itself, have been enough to revoke the charity's status since the auditor was still able to understand the scope and the nature of transactions without them. However, the lack of documentation and disclosure in regards to DATA was found to be more serious, and the Court stated that both failures together were sufficient to conclude that the Minister acted reasonably in revoking the Foundation's charitable registration for failing to maintain inadequate books and records.

3. Farm Sale Transactions

The transactions involved in the Farm Sale Transactions were found by the Court to be sufficient cause for revocation. The Court found that the "primary purpose of the Farm Sale Transactions was not to benefit the concerned charities, but, rather, to use the tax privileges of the concerned charities in order to confer unwarranted tax benefits on the private individuals and corporation involved."[15] The Court also did not believe that that the money paid by the Foundation for the shares of the corporation was a gift and nor that the Farm Sale Transactions were a form of "related business" activity of the Foundation.

D. CONCLUSIONS

The implications of this decision should be considered carefully by charitable organizations at various stages of the audit, objections and appeals process because it questions current CRA positions regarding gifts to foreign charities and the adequacy of books and records maintained by registered charities. It

[13] *Ibid* at para 50.
[14] *Ibid* at para 51.
[15] *Supra* note 1 at para 39.

correctly addresses the long-standing inconsistencies between CRA policy and applicable legislation on the issue of gifts to foreign charities, highlighting the continued difficulties organizations and their advisors face in reconciling CRA policy on many issues, including split-receipting, gifts to non-qualified donees and even the threshold definitions of the various types of charities, and the uncertain state of proposed legislative amendments – difficulties that the charitable sector has had to negotiate for more than 10 years. The decision also calls into question CRA's determination of what constitutes adequate books and records in the face of a vague paragraph 230(2)(a) and suggests that CRA should be more forthcoming about what it considers to be reasonable.