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COMPLIANCE AGREEMENTS: BEWARE OF LATENT PITFALLS

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A. INTRODUCTION

With 2425 audits of registered charities having been conducted by CRA in the past three years, resulting in about 1% of charities being audited each year, there is a about a one in ten chance every ten years that a charity may have an auditor coming to pay a visit.[1] Audits can occur for a number of reasons, one of which may be to follow-up on compliance issues raised during a previous audit, particularly where those issues were addressed through a compliance agreement at the conclusion of the earlier audit. While there are a number of different ways that an audit can be concluded, such as an education letter, a monetary penalty, a suspension of receipting privileges or even revocation of charitable status where there is serious non-compliance,[2] the requirement that a charity enter into a compliance agreement is the second most common method by which audits are resolved by CRA.

Given this fact, it is important that registered charities understand the consequences of entering into a compliance agreement with CRA, both now and in the future, as well as the impact that a compliance agreement may have upon the directors, officers, and managers of a charity. This Bulletin provides a brief overview of these issues.

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[1] Canada Revenue Agency, "The Audit Process for Charities" online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/dtng/dt-prcss-eng.html>.

[2] *Ibid*.

B. COMPLIANCE AGREEMENTS

In cases of non-compliance that CRA considers less severe, the Charities Directorate may propose a compliance agreement as an appropriate audit outcome.[3] According to CRA, "[a] compliance agreement outlines the areas of non-compliance and the remedial actions that the charity has agreed to take, sets out the timelines for the necessary changes and outlines the consequences if the charity does not follow the agreement."[4] The CRA will normally follow up within a few years to make sure the charity is acting in accordance with the agreement.[5] A charity's non-compliance with the terms of the compliance agreement is considered a serious incident of non-compliance by CRA, which means that CRA would be "prepared to move directly to a sanction or revocation."[6]

Despite the severe consequences that can result from failing to comply, compliance agreements are generally seen as an opportunity for a charity to retain its charitable status with CRA while ensuring their constituents continue to receive the charity's valued programs and services. However, all of this is contingent upon the charity ensuring that, on a go-forward basis, it takes steps to implement the corrective actions required by CRA as outlined in the compliance agreement.

Given this expectation, before entering into a compliance agreement, a registered charity, preferably with assistance of legal counsel where possible, should carefully negotiate the terms of a compliance agreement with CRA. This is because the agreement includes an admission by the charity of the areas of non-compliance identified by CRA, as well as an agreement concerning the corrective measures being proposed by CRA. Given the opportunity afforded by CRA to negotiate and clarify the terms of a compliance agreement, it is not possible for the charity to later allege that the terms of the compliance agreement were inaccurate, unfair or misunderstood at the time of a future audit, particularly where ongoing non-compliance with its terms is subsequently found by CRA.

Another important consideration to keep in mind is that, prior to entering into a compliance agreement, the entire board of directors of the charity should be involved in reviewing and understanding the terms of the compliance agreement and then formally authorize the charity to enter into the agreement. In so

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[3] *Ibid.*
[4] *Ibid.*
[5] *Ibid.*
[6] Canada Revenue Agency, Guidelines for applying sanctions (18 September 2011), online: http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/nwsnctns-eng.html.

doing, all of the directors would be aware of the outcome of the charity's audit, the non-compliance which has been identified and the steps, together with required timing, that the charity, under the board's oversight, must take in the future in order to correct the identified areas of non-compliance. Presumably, with this knowledge in hand, the board will be motivated to ensure that steps are taken in the future to correct the charity's compliance issues as identified in the compliance agreement.

C. INELIGIBLE INDIVIDUALS

It is important to note the relevancy of "ineligible individuals" with regards to the consequences that flow if the terms of a compliance agreement are not complied with. In accordance with subsection 149.1(1) of the *Income Tax Act* ("ITA"),[7] "ineligible individuals" are defined as individuals who have been:

a) convicted of a "relevant criminal offence" unless a pardon has been granted for the offense;

b) convicted of a "relevant offence" in the past five-years;

c) a director, trustee, officer or like official of a registered charity when the charity engaged in conduct that could reasonably have constituted a "serious breach" of the requirements for registration under the ITA and for which the registration was revoked in the past five years;

d) an individual who "controlled or managed", directly or indirectly, a registered charity when the charity engaged in conduct that can reasonably have constituted a serious breach of the requirements for registration under the ITA and for which its registration was revoked in the past five years; or

e) a promoter of a tax shelter that involved a registered charity, the registration of which was revoked in the past five-years for reasons that included or were related to participation in the tax shelter.[8] (emphasis added)

[7] *Income Tax Act*, RSC 1985, c 1.
[8] *Ibid*

As such, a person may become an ineligible individual if they were a director, trustee, officer or like official, or "an individual in a position of management or control" of a charity if its charitable status was revoked within the past five years for a serious breach of the ITA, i.e. a governing person.[9] In accordance with its Guidance on Ineligible Individuals, CRA states that in the determination of whether a governing person "is or is not an ineligible individual, the breach that resulted in revocation must be serious."[10] The Guidance indicates that CRA would consider, "any revocation resulting from an audit to be a serious breach."[11] If a governing person unwittingly becomes an ineligible individual, then such person's involvement with another charity may put that other charity at risk of revocation of charitable status or other sanctions, such as suspension of receipting privileges for one year.[12]

Accordingly, charities, as well as their governing persons, need to be aware of those situations which might result in its governing persons becoming susceptible to an "ineligible individual" determination by CRA under section 149.1(1) of the ITA.[13] For example, if a charity had its status revoked in the last five years for non-compliance during a period in which an individual involved with the charity was a governing person, i.e. a director, trustee, officer or like official, as well as an individual in a position of management or control, then CRA could exercise its discretion to determine that such person was an ineligible individual under the ITA, depending on the nature of the identified area of non-compliance. In the event that the governing person was found to be an ineligible individual, and such individual subsequently became involved during the five year period of time from the revocation of the previous charity with a new charity as a governing person, then such governing person could be putting the new charity at risk of sanctions or even revocation of charitable status. This would be the case even if the governing person was totally unaware of the previous charity's revocation.

[9] Canada Revenue Agency, Guidance CG-024 Ineligible Individuals (27 August 2014), online: < http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/cg-024-eng.html>.
[10] *Supra* note 9 (Please note revocation for failure to file will not be considered a serious breach for the ineligible individual determination). For a more complete discussion about ineligible individuals see *CRA Releases Guidance on Ineligible Individuals,* Charity Law Bulletin No 350 by Ryan Prendergast and Terrance S. Carter online: <http://www.carters.ca/pub/bulletin/charity/2014/chylb350.pdf>.
[11] *Supra* note 9 at 19.
[12] *Ibid* at 33.
[13] *Ibid*.

D. CONCLUSION

The lesson to be learned from the above example is that charities need to take pro-active steps to ensure that those who are governing persons of their organizations are not, or have not unwittingly become, ineligible individuals, particularly where the terms of an earlier compliance agreement may have not been complied with and resulted in revocation. Similarly, governing persons of charities should take steps at regular intervals to check the status of the previous charities they have been involved with as governing persons over the last five years in order to determine if they may have had the dubious distinction of unwittingly becoming an ineligible individual, thereby putting their current charity's status as a registered charity in potential jeopardy.

As well, it is equally important to ensure that when a compliance agreement is being proposed by CRA, its terms are carefully negotiated by the charity. In so doing, the charity will better ensure that the negotiated terms in the agreement can realistically be complied with. To not do so could mean that the charity may be planting the seeds of its own destruction at a later time on a follow up audit by CRA, as well as jeopardising the ability of its governing persons to subsequently become involved with another charity for at least five years.

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