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CRA Audits: How to Avoid New Penalties and Sanctions

(Powerpoint Presentation)

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OVERVIEW

- Background
- Audit Process
- Intermediate Sanctions and Penalties
- Practical Considerations

For more information see article entitled "Regulatory Regime - New rules seen as consistent with recommendations of VSI" at <http://www.canadianfundraiser.com/newsletter/article.asp?ArticleID=1792>

2

BACKGROUND

- New rules concerning the taxation and administration of charities set out in the 2004 Federal Budget received Royal Assent on May 13, 2005 and are now in force:
 - New intermediate sanctions and penalties
 - New and more accessible appeals process
 - CRA's internal appeals process
 - Tax Court of Canada
 - Also new DQ rules and increased transparency

3

- Previously, CRA had only one sanction – revocation
- Relatively few audits
- Audits usually reactive, not proactive
- Audits performed by Consulting and Audit Canada, not CRA
- Budget brought increased resources to the Charities Directorate at CRA

4

AUDIT/APPEALS PROCESS

- CRA is gradually providing some guidance with respect to the process related to the implementation of the new rules which it believes is consistent with the graduated educative approach to compliance recommended by the Voluntary Sector Initiative's Joint Regulatory Table report ("VSI report")

5

- CRA's Progressive Approach:
 1. Education (specific and general)
 2. Compliance Agreements
 3. Intermediate Sanctions
 4. Revocation

6

- Steps in the Audit/Appeals process:
 1. Organization is identified for audit
 - Random selection
 - Legislative criteria/concerns
 - Follow-up on non-compliance or complaints
 - Audit of related organization
 2. Office Audit - File is screened by Charities Directorate (entails a review of information on file with CRA and internet) and, if necessary, referred for a field audit

7

3. Field Audit

- On location
- Single or a team
- Examination of books and records relating to bank accounts, investments, expenses, contracts, annual reports, board minutes, and any other documents related to the charity's activities
- Not only an examination of financial affairs, also an examination to determine compliance with legal obligations under the ITA and if operating for charitable purposes

8

4. Audit Report is prepared

- Quite often preliminary findings will be communicated in advance to the charity
- Key document for the organization to obtain because it details the audit findings and the legal basis of any assessment of sanctions

9

5. Letter to charity advising of results

- Education – minor non-compliance
- Compliance Agreement (formerly undertaking letter)
 - Corrective action required: agreement outlines non-compliance and remedial actions that the charity must undertake and includes a paragraph that advises the charity that a penalty and/or suspension could apply if the agreement is not upheld
 - Formal document signed and dated by both parties, includes a timeframe to make changes outlined in the agreement

10

6. Follow-up

- CRA may bring file forward for automatic review to ensure compliance with the agreement
- May be by office or field audit
- If compliant, file likely closed
- If non-compliant, maybe application of interim sanctions

11

7. Application of Interim Sanction/Penalty

- Sanction Assessment letter
- Make payment to CRA or an eligible donee (another arm's length charity) and return sign off form to CRA once payment has been made
- Appeal

12

8. Revocation

- Still available for any offence at any time and can be applied with intermediate sanctions
- The charitable status of a charity may also be revoked if it obtained its charitable registration on the basis of false, misleading or omitted information

13

9. Internal Appeal

- Must 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
- Notice of Objection should identify the decision objected to, the reasons for the objection and all relevant facts
- 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
- Notice of objection is required before an appeal may be brought to the Courts

14

10. Court

- Tax Court: appeals of intermediate sanctions and penalties
- Federal Court of Appeal: application for judicial review of refusals to register, revocation, annulment, and charitable designation

15

INTERMEDIATE SANCTIONS AND PENALTIES

- Purpose of Intermediate Sanctions
The May 2005 amendments establish a more responsive approach to the regulation of charities under the *Income Tax Act* by introducing sanctions that are more appropriate than revocation for relatively minor breaches of the *Income Tax Act*
The sanctions will apply in respect of taxation years that begin after March 22, 2004

16

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 Foundation acquiring control of corporation Failure to comply with certain verification and enforcement requirements (e.g. keeping proper books and records) 	<ul style="list-style-type: none"> \$500 penalty Penalty of 5% of eligible amount stated on receipt Tax of 5% on gross revenue from the offending activity 5% tax on dividends paid to charity Suspension of tax receipting privileges 	<ul style="list-style-type: none"> \$500 penalty. May lead to revocation Penalty of 10% of eligible amount stated on receipt Tax of 100% on gross revenue from the offending activity and suspension of receipt privileges 100% tax on dividends paid to charity Suspension of tax receipting privileges

17

Offence	First Infraction	Repeated Infraction (Within 5 years)
<ul style="list-style-type: none"> 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"> 125% tax on eligible amount of receipts (suspension of tax receipting privilege of total penalties under 188.1(9) exceeds \$25,000 in a taxation year) Tax of amount transferred and 10% of amount transferred Penalty of 105% of benefit 	<ul style="list-style-type: none"> 125% tax on eligible amount of receipts (suspension of tax receipting privilege of total penalties under 188.1(9) exceeds \$25,000 in a taxation year) Tax of amount transferred and 10% of amount transferred Penalty of 115% of benefit and suspension of tax receipt privileges

18

<p>PRACTICAL CONSIDERATIONS</p> <ul style="list-style-type: none"> Perfection is not expected or required

19

Audit Day

- The auditor is not your friend (or enemy)
- ITA 231.1 requires “all reasonable assistance”
- Disclose only required information
- Be responsive
- Make auditor comfortable
- Consider requesting written questions
- Document/demonstrate efforts to comply

20

Books and Records

- Financial records
- Receipts and supporting documentation
- Records demonstrating charitable nature and that all activities have a charitable purpose
- Keep notes and copies of all documents and correspondence
- Privileged documents (communications related to obtaining legal advice, does not include accountants or consultants)

21

Incomplete Receipts

- Income Tax Regulation 3501 requires:
 - Name, Registration # and address of charity
 - Serial # of receipt
 - Date and place of issue
 - Date of receipt of cash gift
 - Date of receipt and description of in-kind gift
 - Value of property received
 - Amount of advantage received by donor
 - CRA name and website URL
- See CRA Website for most recent requirements

22

False Receipts

- **Comply with new reasonable inquiry requirements**
- **Avoid one receipt at end of the year if multiple gifts**
- **Valuation issues: whose is it and can it be relied on – charity should obtain its own independent valuation**
- **Know your donors: Neither valuator nor charity should turn a blind eye to facts or circumstances which may give rise to concerns**

23

Undue Benefit

- **Gifts other than to qualified donee**
- **The amount of any “rights, income, property or resources” paid, payable, assigned or otherwise made available to member or trustee of the charity, or a person who contributed more than 50% of the capital of the charity, or a non arms length person**

24

• **Exceptions**

- **Reasonable remuneration or consideration for property acquired or services rendered**
- **Gift made or benefit conferred in course of charitable activities unless improper eligibility**
- **Gift to qualified donees Avoid excessive salaries**
- **Fundraising contractors and fees**
- **Grants to foreign charities – ensure appropriate agency agreements are in place**

25

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