PFC/CEGN Submission to Consultation on Political Activities

We represent a cross-section of public and private charitable funders in Canada. We wish to submit this letter as part of the Canada Revenue Agency's consultation regarding political activities.

The government has received numerous submissions commenting on the substance of the current tax rules and CRA administrative policy with respect to the interpretation and regulation of political activities by registered charities. We wish to address a related issue: the process by which charities are audited and subjected to sanctions by CRA, including for carrying out political activities that are determined to be non-compliant.

We are concerned that aspects of the charity audit process are unreasonable and inconsistent with the principles of administrative fairness. While the issues outlined below do not apply exclusively in the context of political activity audits, this consultation provides an important opportunity to draw to CRA's attention the unfairness inherent in the charity audit process. Charities undergoing audits for political activities face each of the issues discussed in this submission.

The Federal Court of Appeal has held consistently that the Minister of National Revenue owes a duty of fairness to registered charities when they are subject to audit and potential revocation of charitable status.[1] Revocation entails the loss of tax-receipting privileges, tax-exempt status, and imposes a requirement to pay a tax equal to all of the charity's assets as of the day it receives a notice of intent to revoke. The Court has acknowledged the substantial negative effects of revocation and stated that it is "axiomatic" that a duty of procedural fairness is owed.[2]

We submit that each of the issues below reflects a form of administrative unfairness and we suggest potential remedies.

1. Limitation Period

Most taxpayers who are subject to audit by CRA benefit from administrative protections in the *Income Tax Act* (the "**Act**"). Among these is a limitation period that affords taxpayers certainty as to their exposure to audit and reassessment.

The Act requires that CRA examine a taxpayer's return of income with all due dispatch and issue a notice of assessment. Once a taxpayer receives a notice of assessment, a limitation period applies to any additional assessment or reassessment of the taxpayer. This limitation period (referred to as the "normal reassessment period") is either three or four years (depending on the status of the taxpayer) after the original assessment is sent. The only way that CRA can reassess outside this limitation period is if the taxpayer has made a misrepresentation attributable to neglect, carelessness or wilful deceit, or has committed fraud in filing the return or submitting information required under the Act. Absent such fraud or misrepresentation, taxpayers can have certainty as to the years for which they are subject to audit. This certainty is essential to allow individuals and businesses to plan their affairs.

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[1] *Renaissance International v MNR*, [1982] C.T.C. 393 (FCA).

[2] Lord's Evangelical Church of Deliverance & Prayer of Toronto v. R. , 2004 FCA 397. The Court stated: "It is axiomatic that procedural fairness be accorded to a person in the position of the appellant before a decision is made to revoke a charitable registration. The respondent agrees that such fairness is required. The impact of revocation is palpable. The appellant's income would be subject to tax and the appellant would no longer be able to issue donation receipts. In addition, the appellant could be subject to a revocation tax under section 188 of the Act. Obviously, therefore, revocation would severely impact the appellant in pursuing its objects."

Registered charities have no such protection. Although registered charities are required to file annual information returns with CRA each year, they do not receive notices of assessment. As such, the limitation period in the Act does not apply. CRA is not limited to auditing charities within the normal reassessment period and sometimes engages in audits for periods covering many taxation years. In some cases, charities have been subject to audits covering as much as an eight-year period.

This subjects charities to uncertainty as to the extent of their audit exposure. It is inconsistent with the record-keeping obligations of registered charities, which only require certain records to be kept for between 2-6 years. Exposing charities to audit (and potential penalties) for periods that extend beyond (and in some cases well beyond) the charities' record-keeping obligations is unreasonable.

Recommendation: We submit that registered charities should receive the same protection as other taxpayers. Charities should know with reasonable certainty which years are subject to audit and which are not. Ideally, the Act would be amended to confirm that charities cannot be subject to penalties under the Act for conduct occurring outside a set limitation period. Short of this, however, CRA can adopt and publicize an administrative position establishing a limitation period outside of which CRA will not audit. Appropriate exceptions for fraud or misrepresentation can be adopted in a manner similar to the exceptions to the normal reassessment period that apply to other taxpayers.

2. <u>Audit Delays</u>

We are aware of several instances where charities facing CRA audits have been subjected to unreasonable delays in the processing and resolution of the audit.

Charity field audits begin with a requirement to provide information to CRA, followed by an on-site review by an auditor. Once the field audit is complete, it can take many months or sometimes years before the charity receives any audit findings.

Furthermore, when CRA does provide the audit results, CRA typically provides the charity only a very limited time (usually 30 or 60 days) to reply to its concerns. While CRA will normally grant at least some extensions of this deadline, this is not guaranteed and the charity is dependent on CRA's willingness to grant an extension. A charity may therefore be required to review, analyse and prepare a written response to a substantial volume of documentation and allegations within a very limited timeframe that may not provide adequate time to respond fully.

These delays subject charities to substantial prejudice. As time passes, leadership and staff turn over and institutional knowledge is lost. Memories may fade and records may be lost. All this prevents a charity from responding fully to any allegations of non-compliance. Audit findings may include factual inaccuracies and misunderstandings about the nature of a charity's operations or records. When a charity is subject to lengthy delays before being made aware of CRA's findings, key personnel who would have been able to explain or address these inaccuracies may have left the organization. This can result in inaccurate audit findings not being corrected due simply to excessive delay.

In some cases, CRA appears to leave audit files open indefinitely. This may occur following an initial field audit or request for information, or may occur after CRA has released its preliminary audit findings in the form of an administrative fairness letter and the charity has responded to these findings. In some cases, CRA will not respond for years and the audit will be left in an indefinite state of limbo. It is not possible to compel CRA to close or otherwise resolve an audit. Indefinite delays of this nature have occurred in the context of audits of political activities.

Charities under audits that have "gone cold" in this way are placed in a difficult position. CRA may have sent initial audit findings alleging different forms of non-compliance. The charity may have then responded with its position on why these findings are inaccurate or unfounded. However, in the absence of any further communication from CRA, the charity is left uncertain as to how it should operate going forward. It also leaves the charity under indefinite audit, which may in some cases require disclosure on financial statements, which can harm the charity's reputation and ability to fundraise and operate.

Recommendation: We submit that CRA should endeavour to improve its timeliness throughout the charity audit process. Specifically:

- CRA should strive to improve its service standards in providing initial audit findings and giving charities the earliest opportunity to respond to any concerns; and

- CRA should ensure that it closes all audit files and informs the charity.

3. Reverse Onus

Registered charities are subject effectively to a reverse onus of proof on audit that can make it exceedingly difficult for a charity to overcome a CRA decision on appeal. This appears to us to be inconsistent with the principles of administrative fairness.

When the Charities Directorate audits a charity, it gathers documentation and other evidence on the charity and forms a determination as to whether the charity is in compliance with the Act. Where the Charities Directorate concludes that the charity has contravened a provision of the Act, it will send the charity an administrative fairness letter (AFL) setting out its findings and allegations of non-compliance.

The AFL is a crucial document in the charity audit process. It sets out the issues that the Directorate has identified and the factual and legal bases for its conclusions. The charity then has an opportunity to respond to the AFL with its own factual and legal submissions. However, the AFL "sets the agenda" for the audit issues, which has repercussions throughout the appeal process.

We have been told of instances where CRA has included a wide range of allegations of non-compliance in the AFL. Even if an audit focuses on a single major issue – such as political activities – the AFL may also include allegations of non-compliance based on minor or technical issues (such as technical errors in the form of receipts, or minor errors in T3010 filings). Each of these issues will be cited as an independent basis for revocation.

The result of this approach is that it can be very difficult for a charity to overcome the initial decision of the Charities Directorate through the objection and appeal process. Appeals from revocation go to the Federal Court of Appeal, which reviews the decisions of the Charities Directorate as a judicial review, rather than by way of new trial in the Tax Court of Canada. The Federal Court reviews the matter on the basis of the factual information collected in the audit, with no ability on the part of the charity to submit new information. The Court generally reviews to determine whether, in light of the audit materials reviewed by the Charities Directorate, the Directorate's decision to revoke registration was reasonable. Courts have deferred to the Directorate, and have held that the decision of the Charities Directorate to revoke registration will generally be upheld unless every one of CRA's allegations is rebutted or disproven by the charity.

This process means that CRA can use minor technical errors by the charity – which by themselves would justify no more than an education letter or, at most, a compliance agreement – to buttress allegations of

non-compliance on a central issue and all but ensure that its decision to revoke will not be overturned. Thus, even if the charity is able to rebut CRA's positions with respect to the major allegations of non-compliance, it will still have great difficulty in overturning the decision of the Charities Directorate.

The effect of this is that charities are subject to sanctions, including revocation, at the discretion of the Charities Directorate, with little chance of success in appealing the decision. This amounts to a reverse onus on charities. This is particularly problematic in the context of audits dealing with political activities, where the Charities Directorate has very wide discretion to decide whether a charity has contravened the rules in the Act. The Directorate can make allegations of violations of the rules around political activities and can ensure that its sanctions will be upheld.

This increases the risk that charities face when engaging in activities that could be viewed as political and contributes to the chill in the sector with respect to political activities, as charities are both uncertain as to what is and is not political and rightly concerned at the prospect that they could have their registration revoked without any prospect of success on appeal if the Charities Directorate concludes that they are offside.

One potential solution to this issue would be to revise the current approach under which appeals from CRA decisions to revoke registration are heard as judicial review applications in the Federal Court of Appeal. Instead, such appeals would be heard as new trials, based on newly constituted evidentiary records, in the Tax Court of Canada. This would ensure that charities have the ability to put before the court all relevant evidence. This was recommended by the Joint Regulatory Table in its 2003 report on regulatory reform of the charitable sector. The report stated as follows:

"… we believe that a recourse system that is handling both denied applications for registration and sanctions on a charity requires some form of accessible hearing de novo. A hearing de novo lets organizations put their case before a fully independent arbiter if they are dissatisfied with the outcome of internal reconsideration. Oral testimony and cross-examination permit questions of potential regulatory bias to be tested….

On balance, we believe the Tax Court provides the most accessible option for a hearing de novo. We acknowledge that the Tax Court has no recent experience with charity law, although its predecessors (the Income Tax Appeal Board and the Tax Review Board) determined which organizations were charitable. However, we believe that any court is capable of developing the expertise it needs."[3]

Since the Joint Regulatory Table report was issued, the intermediate sanctions regime for registered charities was introduced to the *Income Tax Act*, and the Tax Court of Canada has had jurisdiction to hear appeals from penalties under the intermediate sanctions regime and from suspensions of charity receipting privileges.[4] While cases to date have been relatively few, the Tax Court of Canada has already been given authority to adjudicate charity compliance issues and the imposition of sanctions and will continue to develop its expertise.

Recommendation: We recommend as follows:

- appeals from sanctions imposed by the Charities Directorate should be held as new trials in the Tax Court of Canada, rather than by way of judicial review to the Federal Court; and

[3] Voluntary Sector Initiative (Canada). Joint Regulatory Table. *Strengthening Canada's Charitable Sector : Regulatory Reform : Final Report* (2003).

[4] *Income Tax Act*, RSC 1985, c.1, 5th Supp., ss. 188.2(4), ss. 189(8).

- the Charities Directorate should adopt a policy under which it limits the stated bases for revocation to significant and serious forms of non-compliance uncovered on audit. To the extent that minor errors or deficiencies are identified, these should not be presented as independent bases for revocation and should not be available to uphold a decision to revoke registration if the central issues have been rebutted.

We thank you for considering these recommendations. We would welcome the opportunity to discuss these submissions further with you.