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Abstract

The Canadian charity tax system continues to evolve. Recent changes considered in this overview paper include the introduction of split receipting (followed by a thick anti tax shelter overlay) and the ever more attractive tax treatment of gifts of appreciated public securities. The paper also discusses the CRA's abandonment of its position on foundation borrowing, the CRA's more aggressive approach to CRA audits (against the backdrop of the new intermediate sanctions and appeals regime) and recent caselaw on foreign activities and the definition of charity.

Introduction

Since 2004,[1] there have been a number of changes to the Canadian tax treatment of charities and donations. This paper, which is designed to provide a brief summary of a number of topics most which could each properly be the subject of an independent paper,[2] gives briefly our views on some of the most important charity tax developments in the last two years.

A number of changes to both the tax treatment of donations and the tax regulatory treatment of charities have occurred in the past two years. In particular, the changes to the treatment of charitable donations have included the introduction of split receipting and the continuing attempts of the Canada Revenue Agency and the Department of Finance and even the Courts to curb the use of charitable donation tax shelters, as well as changes to the treatment of donations of gifts of securities and ecological land.

In the charity tax regulatory regime, there have been a number of noteworthy developments. This paper will discuss the change to the CRA's position on foundation borrowing, the dramatic increase in the number and aggressiveness of CRA charity audits, the impending application of intermediate sanctions, the new appeal regime and recent caselaw on foreign activities and sport as a charitable purpose.

Charitable Giving

Split Receipting

The common law defines a "gift" as a voluntary transfer of property made without consideration or anticipation of benefit.[3] Prior to 2002, the CRA interpreted this common law definition as preventing any receipt for a gift if the donor received any benefit or consideration in exchange or as a result of the donation.[4] Therefore, CRA would not allow a charity to issue an official donation receipt to a donor receiving a benefit and the donor would not receive any charitable donation tax credit or tax deduction.[5]

On December 20, 2002 the Department of Finance proposed to introduce subsections 248(30) to 248(33) to the

Income Tax Act[6] which would allow for split-receipting. The split-receipting rules allow a registered charity to issue an official donation receipt for the "eligible amount" of a donation. The eligible amount of the donation is the difference between fair market value of the property transferred to the charity by the donor less any "advantage" received by the donor.[7] The word "advantage" was defined broadly to include any the value of any property, service, compensation or other benefit received or obtained either immediately

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or in the future by the donor or person dealing not at arm's length with the donor as partial consideration for or in gratitude for the gift. This definition was worded broadly enough to include consideration provided by a person other than the charity receiving the gift.[8]

This draft legislation reversed CRA's former policy on split receipting. Shortly after the draft legislation was released the CRA published interpretational guidelines on the application of the new legislation in situations where receipts might not have been permitted in the past.[9] For example, a portion of the cost to attend a fundraising dinner sponsored by a charity could be split receipted. The donation receipt issued by the charity to the attendees of the dinner would be reduced by the fair market value of the meal and entertainment.

While the split receipting changes described above were introduced originally to provide a benefit to charities and donors by allowing receipts to be issued where none might have once been allowed, over the intervening years they have been turned into anti-avoidance tools. An understanding of this change requires an outline of the charitable donation tax shelter industry and the government's reaction to it.

Charitable donation tax shelters previously available [10]

Valuation-based shelters: buy low — donate high

In the late 1990's, the most common Canadian charitable donation programs were valuation-based. They involved programs whereby donors could purchase goods (artwork, basic foodstuffs and medical supplies were popular) from promoters / fundraising consultants at wholesale or even firesale prices. These same goods could then be donated to particular qualified donees — these qualified donees would issue donation receipts at retail value (backed by professional valuations arranged by the promoters). The value of the resulting tax credit or deduction would, by design, exceed the cost of the donated goods such that the gift would be profitable on an after tax basis.

Initially, valuation based donation programs all involved the donation of goods which could be characterized as multiple items of personal use property. As such, while an individual donor would claim a full-value tax credit, the donor would not report a corresponding income inclusion as a result of the capital gain which arises in the short interval between the purchase of the goods at wholesale and the donor's immediate donation at retail.

Leveraged donations

The second common type of charitable donation program (known as a "leveraged donation shelter") involved a fundraiser/promoter arranging for a loan to a donor to enable the donor to make a charitable gift. At the same time, the donor invested an amount into a fund where the yield generated would enable the funds to grow during the loan term into an amount equal to the loan payable. The initial versions of the leveraged donation program involved interest free loans to donors. These programs were advertised (including on radio spots!) as being superior to buy low — donate high programs because of the absence of a valuation issue.

Individual donors to a leveraged donation program would claim an immediate tax credit equal to the full amount of the gift (made up to a very limited extent of their own cash and largely of borrowed cash). While they would have to pay tax on their share of the sinking fund's income, the programs offered a very significant deferral benefit.

Initial Canadian government responses to charitable donation tax shelters

Definition of gift

The initial response of the CRA to valuation-based shelters was to reassess to deny donation credit claims on the ground that the donations did not involve gifts at law because they were motivated by tax benefit rather than philanthropy. The Federal Court of Appeal disagreed with this approach in The Queen v. Friedberg.[11]

Flawed specific valuations

The CRA was able to attack, with some success, many of the less sophisticated valuation shelters on the basis that the valuations were defective or had been prepared by the promoters (for example, see *The Queen v. Duguay*[12]). However, this approach was not always available and, in any event, required a separate attack on each donation program.

Amendment of personal use property definition

In 2000, the Department of Finance made its first legislative attempt to end valuation-based donation programs. The attempt was made to do so through the introduction of the Act amendments which denied the $1,000 capital gains exemption for personal use property acquired from a promoter for the purpose of making a donation.[13] This amendment had very little impact on the market for valuation based programs, which continued to grow. In fact, the only real impact of the change was that the "wholesale" prices at which goods were sold to prospective donors dropped by an amount large enough to make the gifts cash-flow positive to donors even with the payment of tax on the now taxable capital gain.

Amendment of tax shelter definition

The next legislative attack on valuation-based donation programs was an amendment released in 2003 which changed the definition of "tax shelter" to include situations where tax is saved by way of a tax credit as well as a deduction from income.[14] This change had the effect of requiring valuation based donation programs to seek out a tax shelter identification number which enabled the CRA to track donation based shelters and deny claimed donation tax credits on a systematic basis. The change had little impact on the volume of donations.[15]

Tax Court of Canada and Federal Court of Appeal require bulk valuation

In early 2004, the Tax Court of Canada decided *Klotz v. the Queen*,[16] which involved a donation of a large number of "fine art prints" as part of a valuation-based donation program.[17] The Court accepted the Crown's valuation approach that the market for art for donations was so large that it formed its own market. This valuation theory was based upon a series of U.S. Tax Court cases which had come to this conclusion in examining similar programs which had been promoted to U.S. donors. The Court concluded that this tax shelter market is a bulk market and bulk pricing should be applied. While the Court acknowledged the existence of a specific U.S. tax regulation (with no Canadian counterpart) requiring that donation valuation be on the basis of the market in which the item is "most commonly sold to the public," the decision placed little importance on this distinction.

The Court in Klotz decided that the best evidence of the value of the prints in the tax shelter market was the amount paid by the donor. The result of this finding was that Mr. Klotz's donation ended up costing him the difference between the amount paid for the

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donated prints and the tax saving of about 45% of that amount. Subsequently, in 2005, the Federal Court of Appeal[18] affirmed that bulk valuation is appropriate where the property in question is traded in a bulk market.

In *Canada (A.G.) v. Nash*,[19] taxpayers purchased limited edition prints from a tax shelter promoter who sold groups of these prints to individuals, arranged for appraisals, then located qualified donees willing to accept gifts of the prints. The taxpayers claimed donation credits based on these arranged appraisals, which valued the art at approximately three times what the taxpayers paid. However, on reassessment, the Minister reduced the fair market value of the donated artwork to the price actually paid the taxpayers.

The taxpayers appealed and won at the Tax Court of Canada,[20] but ultimately the Federal Court of Appeal restored the Minister's assessment. Rothstein J.A. held that it was inappropriate to assume that the fair market value of the group of prints was simply the aggregate of the fair market value of the individual prints. Here, the evidence revealed that the promoter only sold groups of prints and that a well-defined bulk market existed within which these prints were sold year after year. Given that the promoter dealt with the taxpayers at arm's length, Rothstein J.A. concluded that the fair market value of the prints could not have been the aggregate individual value of the prints, as an arm's length promoter would have sold the prints at *that* price, rather than the lower price for which the prints were actually sold. As in *Klotz*, Rothstein J.A. held that the price paid by the taxpayers was perhaps the "most probative evidence" of fair market value.

Both the *Klotz* and *Nash* decisions indicate that courts in Canada have begun looking with increasing scrutiny at the valuation of bulk donations, particularly when made in the context of charitable donation tax shelters. These decisions suggest that many valuation-based donation programs may not have been effective even absent the various statutory amendments designed to curtail and prevent their use.[21] Leave to appeal to the Supreme Court of Canada was refused in each case.[22]

Anti-avoidance in the draft legislation [23]

The new provisions that have been piggy backed onto the draft legislation on split receipting impose the broadest and, from the government's standpoint, most promising anti-avoidance measures. Nonetheless, while these provisions were intended to eliminate charitable donation tax shelters, various shelters remain available.

Subsection 248(35) — attack on valuation-based shelters

Proposed subsection 248(35) contains a broad anti-avoidance provision aimed at valuation-based shelters. The section provides that where a donor's cost of property donated is less than the fair market value of the goods donated, no tax relief may be claimed in respect of the excess amount if the property was acquired under a gifting arrangement with a tax shelter as defined in subsection 237.1(1).[24] Even where the donated property was not acquired through a tax shelter program, a deduction or credit in respect of the excess amount may only be claimed under certain circumstances. First, the donor must have acquired the property more than three years prior to its donation.[25] Second, where the property was acquired less than 10 years prior to donation, it must not be reasonable to conclude than one of the main purposes of the acquisition of property was its eventual donation to a qualified donee.[26]

Proposed subsections 248(36) and (39) operate in conjunction with subsection 248(35) to ensure that the basic rule in 248(35) is not avoided by filtering the gift through non-arm's length transactions or by selling property to a charity and then donating the proceeds. Proposed subsection 248(38) provides a blanket rule that deems the eligible amount of a gift to be nil if it is reasonable to conclude that the gift relates to a transaction or series of transactions one of the purposes of which was to avoid the application of subsection 248(35).

Section 248(37) provides a list of excepted gifts to which subsection 248(35) does not apply. Subsection 248(35) does not apply to gifts of inventory, real property in Canada, cultural property, ecological property, and certain securities. Subsection 248(35) also does not apply to gifts made in the year of death.[27]

Proposed subsection 248(41) imposes reporting requirements designed to render more transparent dealings that might arouse suspicion. Subsection 248(41) requires that the donor inform the donee of any circumstances surrounding the transaction to which any of the anti-avoidance provisions might apply; if the donor fails to do this, the eligible amount of the gift is deemed to be nil (as apposed to the eligible amount properly calculated).

At one point charities were proposed to be subject to a parallel due diligence requirement. Formerly proposed subsection 248(40) provided that a charity could not issue a receipt for donations in excess of $5000 unless the charity had made a reasonable inquiry as to the existence of any circumstances in respect of which the anti-avoidance provisions in subsections (31)-(39) might apply. This included making reasonable inquiries into whether an advantage had accrued to the donor that must be subtracted from the eligible amount of the gift to arrive at an eligible amount under subsection 248(31). However, in late 2005, the Department of Finance abandoned this proposed requirement.[28]

Subsection 248(34) — attack on leveraged donation shelters

Leveraged donation shelters are newer and have received less attention from the courts. However, proposed subsection 248(34) attempts to close these shelters by reducing the gift by the borrowed amount. Subsection 248(34) provides that, effective February 18, 2003, the amount of a donation is reduced by any amount borrowed to make the gift if the borrowing is limited recourse (defined broadly). An amount owing is deemed[29] to be limited recourse unless there are *bona fide* written arrangements to repay the debt within 10 years and interest is paid annually within 60 days of the donor's year end and at least at the CRA's prescribed rate.

While the Department of Finance may have intended that loans which were used in early leveraged donation programs be caught by the definition of limited recourse, some newer shelters appear to be designed to allow donors to borrow on a full recourse basis and thereby escape this anti-avoidance rule. These newer shelters involved donors making real borrowing in excess of the amount to be donated and investing the difference in high return investments. Since donors are subject to real economic risk and suffer real economic deprivation by making their gifts, and because the

recipient charities appear to receive real benefit from the donations, it may be that some of these shelters will not be challenged or will survive if challenged.

While the split-receipting/tax shelter anti-avoidance legislation is currently not enacted,

its various components are retroactive to points as far back as December 20, 2002 and CRA is starting to administer these rules as if the legislation was enacted. In a recent advance income tax ruling,[30] the CRA allowed for the split receipting of the donation. The donation was a piece of art to a museum on the condition that the art be loaned back to the donor for the duration of the donor's life. The CRA took the position that the advantage flowing from the loan of the art back to the donor did not invalidate the gift. The ruling assumed that the work qualified as cultural property within the meaning contained in subsection 118.1(1) and that proposed subsection 248(35) would not apply to deem the fair market value of the gift to be the individuals cost of the property. Similarly, the CRA has confirmed its intent to apply the new anti-avoidance rules to past tax shelter transactions.[31]

Gifts of Securities

The best news for the charitable sector last year was the Federal 2006 budget announcement that donors will not have to pay tax on the capital gain realized when publicly listed securities are gifted to a qualified donee, other than a private foundation.[32] This capital gains exemption only applies to shares, debt obligations and rights listed on a prescribed stock exchange, shares of the capital stock of the mutual fund corporation, a unit of mutual fund trust, an interest in a related segregated fund trust, or a prescribed debt obligation.[33] The prescribed stock exchanges in Canada include the Montréal Stock Exchange, the Toronto Stock Exchange, and Tiers 1 and 2 of the TSX Venture Exchange[34] but not foreign or domestic over-the—counter markets. Donors of securities listed on a foreign exchange should check regulation 3201 of the Act to ensure the capital gains exemption will apply.

This change became law on June 22, 2006 and applies to gifts made after May 2, 2006. The provinces supported this change with both Ontario and Quebec (the only provinces with independent personal income tax systems) announcing that they would harmonize the provincial statutes to eliminate the capital gain on such gifts.[35]

Prior to the announcement, the taxable capital gain on gifts of publicly listed securities was ¬ of the capital gain. Thus, gifts of publicly listed securities were already taxed at half of the rate of normal capital gains. The following table indicates the tax benefits provided by this exemption.[36]

	Cash	997 — May 1, 2006 (25% inclusion rate on capital gains)	May 2, 2006 (0% inclusion rate on capital gains)
Amount of donation	$100	$100	$100
Tax credit [1]			
Federal	$29	$29	$29
Provincial	$17	$17	$17
Reduction in capital gains tax [2]	—	$7	$14
Total tax assistance	46%	53%	60%
Donor's share of the cost of the donation	54%	47%	40%

[1] Assumes that donor has made other donations totalling $200 or more in the year, so that the top tax credit rate applies.

[2] Reduction from the standard 50% inclusion rate that would apply if the individual sold the security. Assumes that the adjusted cost base of the security is $40.

When the capital gains inclusion rate was reduced in 1997 to 25% donations of public securities grew from approximately $69 million in 1997 to over $200 million in 2004.[37] The 2006 Federal Budget estimated that the complete elimination of the capital gains tax on public securities donations would cause such gifts to increase to about $300 million a year.[38]

The impact of these measures on the charitable sector was seen almost immediately. In May, two very large donations were publicized. Larry and Judy Tanenbaum gifted $50 million in securities to the endowment arm of the UJA Federation of Greater Toronto.[39] Peter Munk donated $37 million to the Toronto General Hospital.[40] In October, Joseph and Wolf Lebovic made a $50 million gift to Mount Sinai Hospital.[41]

While this tax relief does not yet extend to such donations made to private foundations, the Conservative government stated it intends to enact similar relief for gifts to private foundations provided a suitable regime can be developed to prevent inappropriate self-dealing transactions involving individuals who control public corporations and who exercise control over the private foundations to which the shares are donated.[42] In December 2006, the Standing Committee on Finance recommended a five-year trial basis elimination of capital gains tax on donations of publicly listed securities to private foundations.[43] The committee also recommended eliminating of capital gains tax on donations of real estate to charities.

Investment Asset Rollover

The charitable sector has raised concerns that the Conservative election promise to treat sales of investment assets on a rollover basis if the proceeds were reinvested in other investment assets.[44] If implemented, this rollover may reduce the incentive to gift publicly listed securities. Whether this promise will become law remains to be seen, though at least one report indicates that the Federal Government plans to move ahead with it in due course.[45]

A Note about Flow-Through Shares

As a way to encourage exploration in the resource sector, the Federal Government used flow-through shares, which allowed companies to pass along exploration deductions to investors.[46] Given that resource-sector companies are generally not profitable during the exploration stage, the company has little room to use the exploration losses. Flow-through shares allow investors to use the costs of exploration to off-set gains elsewhere, while enjoying the possibility of receiving a capital gain in the shares.

The introduction in May, 2006 of an exemption from capital gains tax for donations of publicly-listed securities to registered charities means that donations of flow-through shares have the potential to cost investors very little. For example:

> An investor purchases $10,000 in flow-through shares of a publicly-listed issuer. The issuer agrees to renounce to the investor the deductible exploration expenses incurred. essentially this reduces the cost base of the shares to zero as the investor receives $10,000 worth of deductions which equates to savings of approximately $4,600 (assuming a combined marginal tax rate of 46%). Thus, the net cost of the investment after deduction of these costs is $5,400 ($10,000-$4,600).[47]

Once the resource development is complete and the shares become marketable, then the investor can donate the flow-through shares to a registered charity and pay no tax on the

gain of $10,000 (assuming the shares are still worth $10,000 - a big assumption). The adjusted cost base of the shares is now zero. The investor receives a tax receipt for $10,000 which will shelter other income from tax. Assuming the investor is entitled to donation tax credit based on the current value of $10,000, which provides a tax savings of $4,600, it leaves the investor with an actual cost of only $800 ($5,400 - $4,600)."[48]

There are, however, reasons for charities to be cautious about accepting flow-through shares. For example, the shares might be subject to hold periods or have other restrictions. Such attributes affect the marketability of shares and may suggest that fair market value for receipting purposes is not the original cost, or even the current trading price. For receipting purposes, fair value of the flow-through share security must be determined with care.[49]

Gifts of Ecologically Sensitive Land

Since 1995, the Canadian Ecological Gift Program has allowed Canadians with ecologically sensitive land to protect nature and leave a legacy by donating the property or property rights, including an easement, covenant or Quebec servitude, to an eligible charity or the government. The 2006 Federal Budget made this program more attractive by eliminating the capital gains tax on any gain realized on a donation made under this program made after May 2, 2006.[50] Individual and corporate donors can still claim a tax credit or deduction, respectively, for the value of the gift up to 100% of their net income and carry forward remaining credit or deduction for 5 years.[51] The Provincial Governments of Ontario and Quebec have announced that they would harmonize their systems regarding ecological gifts.[52]

Prior to this announcement capital gains on such donations were included at half of the normal capital gains rate. Thus, only 25% of the gift was subject to capital gains tax when property was gifted to a charity, opposed to 50% if the individual sold the property itself. Now the same gift will result in no capital gains tax.

Ecologically sensitive land is property that currently, or could at some point in the future contribute significantly to the conservation of Canada's biodiversity and environmental heritage.[53] Since the program's inception in 1995 over $141 million worth of ecologically sensitive property has been donated protecting 45,100 hectares of land.[54]

In order to receive the tax benefits under this program, the Minister of the Environment must certify the property as ecologically sensitive land and certify the fair market value of the land.[55] In order to certify the land the Minister of the Environment requires donors to submit a report on the ecologically sensitive nature of the gift and an appraisal report on the fair market value of the land. After reviewing the report the Minister will issue a Notice of Determination of the fair market value of the gift, which unless disputed will be the value of the tax credit or deduction to the donor.

Currently, there are 172 charities eligible to receive the donations of ecologically sensitive property.[56] A Charity can apply to Environment Canada to become an eligible recipient a charity if it is registered in Canada and has a primary purpose such as "the conservation and protection of Canada's environmental heritage." While Environment Canada does not prevent a private foundation from applying to become an eligible charity, the capital gain on donations of ecologically sensitive property to a private foundation is currently still subject to capital gains tax at the normal rate. Along with

gifts of publicly listed securities, discussed above, the government is considering extending the elimination of capital gains tax on gifts to private foundations of ecologically sensitive land.[57]

Recipients of gifts of ecologically sensitive land are responsible for maintaining the biodiversity and environmental heritage of the property in perpetuity. Environment Canada expects a recipient charity to have a management plan regarding environmental stewardship, monitoring, visitor safety, and remediating environmental hazards. The recipient must also consider the costs of ongoing liability insurance and property taxes. If a charity or municipality disposes of the property or changes the use of the property without the permission of the Minister of the Environment, the charity or municipality must pay a tax of 50% of the fair market value of the land.[58]

Case Law

Benquesus

One interesting recent donation case was the decision of the Tax Court of Canada in Benquesus v. Canada.[59] In the case, the transaction at issue was the transfer of funds by Mr. Benquesus, a non-resident father of four adult Canadian resident children. He transferred funds to a Canadian registered charitable organization, but did so on the basis of documents confirming that the funds transferred to the charity were loaned to the charity — he then gifted the loan receivable to his children.

The children partially forgave the loan in 1999, prompting the charity to issue the children charitable receipts for the amounts forgiven. The CRA reassessed the childrens' tax returns and disallowed the charitable donation tax credits claimed by them on the basis that the funds were really gifted to the charity by Mr. Benquesus, the father.

However, the Court determined that the father had gifted the funds to the children, leaving it for them to decide whether and how much money to donate to the charity. The Court looked at the common law definition of a gift, finding that the three requirements of a valid gift were present.[60] There was an intention to donate, acceptance of the gift by the donee and delivery of the gift to the donee. As a result, the funds were gifted by Mr. Benquesus to his children and it was ultimately up to the four children to determine how much to donate to the charitable organization.[61]

This case is an interesting contrast with *R. v. Bromley*.[62] In that case an individual loaned money to a charity then gave the loan receivable to his arm's length lawyer who forgave the loan. The CRA, perhaps because of the absence of family ties in this situation, viewed the matter very seriously and charged the lawyer with evasion. The accused was acquitted conclusively and the Court certainly did not conclude that the Crown's underlying tax liability theory was necessarily correct.

Charity Tax Regulatory Changes

Foundation Loans

Prior to 2005, the CRA took the position that a charitable foundation borrowing to invest was incurring a debt that a foundation was not otherwise permitted by the Act to incur. Subsection 149.1(3) (applicable to public foundations), and s. 149.1(4) (applicable to private foundations), give the Minister the power to revoke the charitable status of a foundation in a variety of circumstances, including where a foundation has incurred certain types of debt. The relevant provision, which is worded identically in both s.149(3)

and (4) permits revocation of a charity that:

> incurred debts, other than debts for current operating expenses, debts incurred in connection with the purchase and sale of investments and debts incurred in the course of administering charitable activities;

While on the face of it, the exceptions seem so broad as to exclude all debts, including ones made for the purpose of permitting investments to be purchased the CRA for many years took the position that the reference to "debts in connection with the purchase and sale of investments only contemplated short-term amounts owing to a broker (for example) after a purchase has been made, as opposed to longer-term debt associated with borrowing to buy investment assets.[63]

As a result of a challenge brought by way of judicial review by the Acorn Foundation, the Federal Court Trial Division suggested that it was prepared to reconsider this interpretation[64] and the CRA issued a technical interpretation[65] accepting that foundations may borrow to purchase investments.[66] This change is potentially quite beneficial to donors in some situations. For example it allows a high net worth/low income donor to capitalize a private foundation now, delaying the use of the tax credit until needed (perhaps as a result of death).

CRA Audits [67]

Historically, CRA charity audits were rare and were usually resolved through compliance undertakings.[68] The CRA has taken a more rigorous approach to auditing charities following the introduction of intermediate sanctions and the new objection and appeal process. Audit activity in the sector increased and in 2006, the Canada Revenue Agency Charities Directorate estimated that 1% of the registered charities in Canada would be audited.[69]

The Charities Directorate stated that it hoped the increased audit activity would lead to enhanced compliance with the requirements of the Act by educating charities. The Charities Directorate assured charities and charity tax professionals that the introduction of the intermediate sanctions would not change the educational approach to charity audits.[70]

In the past, the severe consequences of revocation (until recently the only sanction available to the CRA), including the loss of tax exempt status, loss of ability to issue official donation receipts and a revocation tax equal to full value of the charities assets made the CRA reluctant to apply the revocation sanction.[71] The published policy of the CRA and our experience until recently was that the CRA would only revoke if a charity was found to be engaged in egregious behaviour akin to fraud or if the charity was ignoring the undertakings it made as a result of a previous audit.[72]

Over the last year, we have seen a disturbing trend of auditors proposing to revoke registration for relatively trivial non-compliance issues that would have been the subject of an education letter of undertakings in the past according to Guide T4118. Revocation appears to be pushed by CRA for first time offences, despite the willingness of the charities to undertake or agree to comply in the future. We had expected an audit crackdown as a result of the introduction of intermediate sanctions - this has occurred but seems to have started with revocations for audit years preceding the application of intermediate sanctions.

Perhaps this is due in part to the movement of the audit program from the direct control of the Charities Directorate to the local CRA Tax Services Office tax auditors. These auditors seem to bring a tax compliance mandate to bear on charities audits, since they are proposing to revoke charities in situations that would not have resulted in revocation in the past. These auditors may not have as much background in the charity sector and seem to take the approach that the charities under audit have been chosen for a reason and are likely to be non-compliant.

Intermediate Sanctions

As discussed above, traditionally revocation was the only sanction that could be imposed on a charity and it had drastic consequences. The 2004 Federal Budget changed this with the introduction of the intermediate sanctions.[73] Intermediate sanctions are designed as alternatives to the revocation of charitable status for minor or unintended infractions. The table below sets out the intermediate sanctions.

Section	Infraction	Penalty	Penalty for Repeat with 5 years of first assessed penalty
188.1(1), (2), 188.2(1)	Private foundation carrying on any business or other charity carrying on an unrelated business	5% of gross revenue from the business	100% of gross revenue from the business; suspension of authority to issue official receipts for one year
188.1(3), 149.1(12)	Foundation acquires control of a corporation	5% of the dividends received from the corporation	100% of dividends received from the corporation
188.1(4), (5), 188.2(1)	Undue personal benefit provided by a charity to any person	105% of the amount of the benefit	110% of the amount of the benefit; suspension of authority to issue official receipts for one year
188.1(6)	Failure to file or late filing of information return	$500	
188.1(7), (8)	Issuing receipts with incorrect information	5% of the amount on the receipt for which a credit or deduction may be claimed	10% of the amount on the receipt for which a credit or deduction may be claimed
188.1(9), (10), 188.2(1)	Knowingly making a false statement or causing another to make a false statement on a receipt	125% of the amount on the receipt for which a credit or deduction may be claimed (or the penalty under 163.2 if greater); if penalty exceeds $25,000 then suspension of authority to issue official receipts for one year	
188.1(11)	Delay expenditure of amounts of charitable activities through the transfer of fund to another registered charity	Each charity is jointly and severally liable to a penalty of 100% of the fair market value of the property transferred	
188.2(2)	Contravention of verification and enforcement provisions including books and records, audits and requirements to provide information;	Suspension of authority to issue receipts for one year	
188.2(2)	Receipting on behalf of a suspended charity	Suspension of authority to issue receipts for one year	

Penalties in excess of $1000 in a year can be paid to an "eligible donee" instead of the government.[74] Penalties can also be reduced by expenditures on the charity's own charitable activities in excess of its income for the year.[75]

The sections apply in respect of taxation years that begin after March 22, 2004. Thus, for charities with a December 31st year end will apply in 2005. While the CRA has just now started to audit years in which these sanction may apply, we are not aware of any intermediate sanction assessments having been issued — thus it is unclear how CRA will apply the rules and how the courts will interpret them.[76] Hopefully these rules will be applied sensibly considering other attempts to educate the charity and the severity of the breach, rather than penalizing charities for inadvertent and technical contraventions. Also it is hoped that these rules will be applied before CRA resorts to revocation, rather than applying the intermediate sanctions together revocation.

The New Appeal Process: Implemented, but not yet Populated

A new appeals process has been implemented which is applicable to all CRA charity compliance decisions, in respect of notices issued by the Minister of National Revenue after June 12, 2005.[77] Prior to the 2004 Federal Budget, a charity could only appeal CRA decisions regarding the failure to register the charity and decisions to revoke the registration of a charity. These appeals were taken to the Federal Court of Appeal which was costly and charities could not add further evidence.

This prior appeal system often forced charities to acquiesce to CRA demands, such as an undertaking letter. Since the undertaking letter was based on an administrative practice set out in CRA Guide T-4118, "Auditing Charities", the ordinary appeal mechanism of judicial review by the Federal Court of Appeal was not available to a charity facing a choice between revocation and signing an undertaking.[78] While a charity could allow the CRA to revoke the charity's registration and then bring a judicial review appeal to the Federal Court of Appeal this was a costly and risky choice. Therefore, charities usually acquiesced to the CRA demands, even if the charity and its advisors believed on a reasonable basis that the undertakings were unnecessary (on the other hand, it is now clear because one charity refused to so acquiesce that a charity facing an unreasonable undertaking demand is able to bring a judicial review application in the Federal Court of Appeal).[79]

Under the new appeal process charities can object to a wide range of decisions under 165(1) of the Act.[80] Charities objecting to a penalty, revocation, revocation tax, annulment, decision not to register the charity or a suspension of the charities ability to issue official receipts must first serve the Minister a notice of objection on or before the day that is 90 days after the day the assessment is mailed.[81] The Notice must identify the decision objected to and relevant facts. The Appeals Branch of CRA will review the decision. The Appeals Branch has the power to uphold, vary, or disagree with the original CRA decision.

If the charity wants to appeal the decision of the Appeals Branch the process depends on the matter involved. Decisions on the registration, charitable designation, revocation and annulment will still be appealed to the Federal Court of Appeal.[82] Other appeals including the amount of revocation tax assessed, a suspension of the charities ability to

issue official receipts and intermediate sanctions can be appealed to the Tax Court of Canada.[83] A charity can also apply to have the Tax Court of Canada postpone the suspension of its receipting privileges even before an appeal is launched.[84]

New rules have not yet been promulgated in the Tax Court to deal with intermediate sanction appeals, however we assume such appeals will function like ordinary tax appeals.[85] Thus, the charity should be able to present new evidence and avail itself of the informal procedure.

Currently these procedures not been populated with cases, although the internal appeals process is beginning to see files (we have a couple of revocation matters at Appeals, but none have yet been resolved). Hopefully the new process will be more accessible and responsive to the needs of charities. We shall see as these matters come before the courts in the next few years.

It will be interesting to see how Appeals conceives its mandate in handling charity appeals. It is not clear whether the Appeals review should be aimed at the correctness (can the decision be defended?) of the CRA's decision or at the advisability of the decision (was the decision the right one in the circumstances?) given that the imposition of both revocation and intermediate sanctions is discretionary. It is also not clear whether the introduction of CRA Appeals involvement reduces or eliminates the duty of fairness imposed on the CRA Charities Directorate in revocations matters by *Re: Renaissance International*[86] - we suggest not.

Case Law

Bayit Lepletot [87]

The Federal Court of Appeal judgment in *Bayit Lepletot* denied a charity's appeal of its revocation of charitable status.[88] At issue was whether the charity carried on its own charitable activities overseas. The Act requires that a Canadian registered charity devote its resources to its own charitable activities or make to grants to qualified donees.

Bayit Lepletot ("Bayit Canada") was a Canadian registered charity established to support an Israeli organization with the same name ("Bayit Israel"). Bayit Canada had appointed Rabbi Stern, an Israeli resident, as its agent to carry out charitable activities in Israel. Rabbi Stern was the "Directorate in Residence" of the three charitable institutions for orphans operated by Bayit Israel.

The Court confirmed that a charity can carry on its own activities overseas through an agent because under the common law the activities of an agent are deemed to be activities of its principal.[89] However the court stated that it must be shown that the agent is actually carrying on the charitable works. In this case the court held that the charitable works were those of Bayit Israel, not Rabbi Stern. Therefore, since Bayit Canada had an agency agreement with the wrong party in Israel it was not carrying on its own charitable activities.

The court also dismissed on the facts the alternative argument that Rabbi Stern had a sub-delegated his agency functions to Bayit Israel. While the Court accepted the potential application of the subagent doctrine, it concluded that this case lacked the factual basis for concluding that such a subagency arrangement had been implemented.

Therefore, the *Bayit* case, judgment stands for two propositions:

- while a Canadian charity may carry out its own charitable activities through an agent, it is important to ensure that the agent appointed is actually the legal person that carries out the activities on the ground, and
- it may be possible for an agent appointed by a Canadian registered charity to sub-delegated the charitable work of the Canadian organization to a subagent provided there is factual proof of the sub-delegation.

A.Y.S.A.

In *A.Y.S.A. Amateur Youth Soccer Association v. Canada Revenue Agency*,[90] the Federal Court of Appeal held that an organization whose purpose was the promotion of amateur soccer could not be registered as a charity.

The Amateur Youth Soccer Association ("AYSA") was established to promote the sport of soccer in Ontario, especially amateur youth soccer. The Federal Court of Appeal noted that the main objective of AYSA was to offer youths the opportunity to develop pride in their abilities and soccer skills. It was common ground that AYSA's purpose and object was the promotion of soccer as an end in itself and that this purpose was not incidental to any other purpose.

CRA refused to register the charity stating that the promotion of sport in itself is not a charitable activity. In its refusal letter CRA took the view that while the promotion of health (a recognized charitable purpose) may include activities aimed at increasing the physical fitness of youth through sporting activities, AYSA was focused on the promotion of soccer, not the promotion of health through physical fitness.

As the term charity is not defined in the *Act*, courts must rely on common law definition of charity. AYSA argued that the Ontario case of *Re Laidlaw Foundation*,[91] supported the proposition that under Ontario law the promotion of athletic sport is, by itself, a charitable purpose. AYSA conceded that the overwhelming weight of the common law authorities was consistent with the view that the promotion of sport per se is not charitable, but it argued that the Ontario common law and *Laidlaw* applied.

The Federal Court of Appeal noted that the courts have consistently held throughout the common law world that the pursuit of sports was not charitable, unless it was incidental to some other purpose. However rather than decide if sport in itself was charitable, the Federal Court of Appeal held it did not need to decide the issue because the Act already provided for the tax status of sports organizations in a manner which precludes the possibility of AYSA being registered a charitable organization. According to the Federal Court of Appeal the specific tax exemption for Canadian amateur athletic associations precludes the possibility that AYSA could qualify as the charity. Registered Canadian Amateur Athletic Associations (RCAAA) that promote sports on a national basis can issue tax receipts under the Act.[92] The Court held that "Parliament must be taken to have been aware that no association which has, as its main purpose, the pursuit of amateur sport could qualify as a charity under the common law, and hence, under the Act... In my view, this scheme precludes the possibility that an amateur sport association be treated as a charity under the Act."[93]

This broad statement caused concern that a sports organization can never be a charitable and it contradicts the earlier recognition that sport is charitable when incidental to another charitable purpose. These statements can only be reconciled if the Court's statements are limited to sport organizations that are not charitable under the existing common law.

Under this interpretation the decision supports the proposition that the introduction of RCAAAs meant that Parliament did not intend to make organizations organized solely for the purpose of the promotion of sport in itself charitable, but rather it granted charity-like benefits to such organizations operating nationally.

The Appellant has been granted leave to appeal to the Supreme Court of Canada. Hopefully, the Supreme Court will narrow the unnecessarily broad statements made by the Federal Court of Appeal. The Supreme Court of Canada will also have the opportunity to clarify the proper interaction between charities and RCAAAs, as well as, opine on whether the promotion of sport itself is charitable.

Conclusion

The case law and policy changes that have occurred over the last several years reveal that charities law has changed in a number of ways. Some developments, like the introduction of a new appeals process and intermediate sanctions, are likely to have a relatively large impact on the not only the way that charities conduct their activities, but also how the CRA monitors the sector. To some extent, these changes have already brought about a modification of CRA monitoring mechanisms, as the increase in CRA audits shows.

Other changes, however, provide more in the way of clarification than outright change. The case law reveals that litigation is causing a slow evolution of charities law. At the same time, some of the recent developments coming from the CRA, like its explanation of the public benefit test, also reveal a gradual approach to changes in the rules governing charities. Nevertheless, these less radical alterations to the law affecting charities are equally as important as the more dramatic shifts that have happened in recent years. As the charitable sector continues to increase in importance, staying current on the information and changes affecting the industry is important to all stakeholders, from donors and charities to their tax advisors.

DRAFT FOOTNOTES

1 When the Canadian Tax Foundation Annual Conference last included a set of charity tax papers: Susan M. Manwaring and Robert B. Hayhoe, "Charities Update: 2004 Budget Proposals," *Report of Proceedings of Fifty-Sixth Tax Conference*, 2004 Tax Conference (Toronto: Canadian Tax Foundation, 2005), 8:1-28; and Patrick J. Boyle, "Charitable Gifts: An Update," *Report of Proceedings of Fifty-Sixth Tax Conference*, 2004 Tax Conference (Toronto: Canadian Tax Foundation, 2005), 7:1-36 ("Boyle CTF").

2 Indeed, as we will show through our citations, a number of these more detailed papers have already been written by us or others.

3 See *Friedberg v. The Queen*, (1991), 92 D.T.C. 6031; [1992] 1 C.T.C. 1 (F.C.A.), aff'd [1993] 4 S.C.R. 285 and *Woolner v. Canada* (Attorney General) (1999), [2000] 1 C.T.C. 35; (1999), 53 D.T.C. 5722 (F.C.A.).

4 For more detail on the traditional definition of gift, see David P. Stevens, "Update on Charity Taxation", in Report of the Proceedings of the Fifty-Third Tax Conference, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2001) 28:1-56.

5 That said, as discussed in Boyle CTF, supra note 1, the case law did sometimes permit partial receipting: *Aspinall v. M.N.R.*, (1970), 70 DTC 1669 (TAB), *The Queen v. Zandstra,* (1974), 74 DTC 6416; [1974] CTC 503 (FCTD), *The Queen v. McBurney*, (1985), 85 DTC 5433; [1985] 2 CTC 214 (FCA) and *Woolner*, supra note 3. On one theory, this was a recognition that the Quebec civil law contained a different definition of gift: Blake Bromley, "*Flaunting and Flouting the law of gift: Canada Customs and Revenue Agency's Philanthropobia"* (2002), 21 Est. and Tr. J. 177-208.

6 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Statutory

references in this paper are references to the Act unless otherwise indicated.

7 Proposed Subsection 248(31).

8 Explanatory Notes to Section 248(32).

9 Income Tax Technical News No. 26, December 24, 2002.

10 For a more detailed description of charitable donation (and other) tax shelters in Canada, see Graham Turner, "Tax Shelters — Past, Present and Future," (2003) 1654 *CCH Tax Topics* 1 or Gabrielle St. Hilaire, "Buying Law, Donating High: Arrangements, Programs, Schemes and Scams" (2006) vol. 16, no. 10 *Canadian Current Tax* 101-106. The first draft of a portion of this section of this paper was based on R. Hayhoe, "The End of Charitable Donation Tax Shelters in Canada?" (2004), 44:1 *Exempt Organization Tax Review 69*.

11 (1991), 92 DTC 6031; [1992] 1 CTC 1 (FCA) (upheld by the Supreme Court of Canada on other grounds, (1993), 93 DTC 5507; [1993] 2 CTC 306). However, see *McPherson v. Canada* [2006] T.C.J No. 519 where the Court concluded that a donation resulting in a cash "Kickback" of 75% of the donated amount was not a gift.

12 2000 DTC 6620; [2002] 1 CTC 8 (FCA)

13 Subsection 46(5).

14 Section 237.1.

15 Indeed, Graham Turner, *supra* note at 4, suggests that the change actually resulted in an increase in volume!

16 2004 TCC 147; [2004] 2 CTC 2892.

17 Interestingly, the Klotz donations were to the University of Florida, which is a qualified donee for Canadian tax purposes. It appears that some promoters of these programs arranged specifically that the prints would be donated to non-Canadian qualified donees, perhaps on the theory that the *Act* gives the Canada Revenue Agency no practical ability to oversee their issuance of charitable donation receipts.

18 2005 DTC 5279 (FCA)

19 2005 DTC 5696; [2006] 1 CTC 158 (FCA).

20 2004 DTC 3391 (TCC).

21 Although, since valuation is a matter of fact (as acknowledged by Revenue Canada in the gift context in Revenue Canada document no. 9800605, January 26, 1998), this conclusion may not always be true.

22 *Nash v. Canada,* [2006] S.C.C.A No. 20, [2006] S.C.C.A. No. 21, [2006] S.C.C.A. No. 22; *Klotz v. Canada* [2005] S.C.C.A. No 286.

23 There has been extensive commentary on these proposed anti-avoidance rules. See Rob DePetris, "Stopping Perceived Abusive Charitable Tax Schemes and Much More," in *2004 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2004), 5B:1-17; J. Maureen Pappin, CA, "December 20, 2002 Draft Technical Changes - Charitable Donations, Charities and Trusts," in *2003 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2003), 5:1-32.

24 Proposed Paragraph 248(35)(a).

25 Proposed Subparagraph 248(35)(b)(i).

26 Proposed Subparagraph 248(35)(b)(ii).

27 Proposed Paragraph 248(35)(b).

28 In response to vociferous objections on the part of charities and their advisors: Robert B. Hayhoe, "Federal Legislation Creates New Diligence Requirements for Charities" (2005), vol. 25, no. 16 *Lawyers Weekly* 10 and Robert B. Hayhoe, "Finance Abandons Diligence Requirement for Charities Receiving Large Gifts" (2005),

vol. 25 no. 30 *Lawyers Weekly* 8.

29 By proposed subsection 143.2(6.1).

30 CCH, "Gift of Work or Art Combined with Loan for Use", Window on Canadian Tax Commentary, 2006, #8773. See also CRA document No. 2006 — 0170391R3, Advance Income Tax Ruling, August 2, 2006.

[31] Canada Revenue Agency "Warning Tax Shelter Gifting Arrangements are Risky" Alert, October 31, 2006.

[32] Canada, Department of Finance, 2006 Budget, Budget Plan, May 2, 2006.

[33] Subsection 38(a.1).

[34] Regulation 3200 and 3201.

[35] Ontario Ministry of Finance Information Bulletin, "Supporting Donations to Charities and Gifts of Ecologically Sensitive Land", August 2006, and Revenue Québec, Income Tax Return/Guide 2006, "393 Donations and Gifts", 51.

[36] Adapted from the 2006 Budget, 121.

[37] 2006 Budget, 122. For discussion, about the policy rationale and ramifications of the incentive, see Alexandre Laurin, "The Taxation of Capital Gains on Charitable Donations of Listed Securities", Library of Parliament, Parliamentary Research Branch, November 13, 2003.

[38] 2006 Budget, 122.

[39] Campbell Clark, "Tanenbaum family donates $50-million", Globe and Mail (20 May, 2006)

[40] CBC News, "Munk donates $37 million to cardiac centre" (May 30, 2006)

[41] Dawn Walton "Brothers to give $50-million to Toronto hospital; Mount Sinai to benefit from largest-ever single donation", *The Globe and Mail* (27 October 2006) A3.

[42] 2006 Budget, 123.

[43] Report of the Standing Committee of Finance, "Canada: Competing to Win" December 2006.

[44] Conservative Party of Canada Federal Election Platform 2006, Stand Up for Canada, 16. The Conservative Party pledged to "Eliminate the capital gains tax for individuals on the sale of assets when the proceeds are reinvested within six months. Canadians who invest, or inherit cottages of family heirlooms, should be able to sell those assets and plough their profits back into the economy without taking a tax hit."

[45] It appears that the Federal Government intends to pursue the asset rollover. See Jack M. Mintz, "Tory Tax Relief: The Conservatives will deliver on their promise to give investors relief from capital gains tax", National Post, October 11, 2006.

[46] For more detail on the tax treatment of flow-through shares, see Vijay M. Jog, Gordon J. Lenjosek, and Kenneth J. McKenzie, "Flowthrough Shares: Premium-Sharing and Cost-Effectiveness," (1996), vol. 44, no. 4 Canadian Tax Journal, 1016-1051.

[47] Bryant Frydberg and Susan Manwaring, "Charitable Donations and Flow-Through Shares", 20 *Charitable Thoughts* No. 1.

[48] Ibid.

[49] Ibid.

[50] Proposed Section 38(a.2).

[51] Paragraphs 110.1(1)(d), 118.1(1)"total ecological gifts" and "total gifts", and 118.1(3).

[52] For an overview of the programs in Quebec see Environment Canada, "The Ecogifts Program in Quebec", online: Environment Canada <http://www.qc.ec.gc.ca/faune/pde-egp/procedure_e.asp> and in Ontario see http://www.on.ec.gc.ca/wildlife/ecogifts/ecogifts-e.html

[53] We are not aware of land outside of Canada ever qualifying, although we see no reason in principle why it could not: Robert B. Hayhoe, "A Critical Description of the Canadian Tax Treatment of Cross-Border Charitable Giving and Activities," (2001), vol. 49, no. 2 Canadian Tax Journal, 320-337 at 328.

[54] See the Canadian Ecological Gift Program website for more information at http://www.cws-scf.ec.gc.ca/egp-pde/

[55] Paragraphs 110.1(1)(d) and 118.1(1) "total ecological gifts".

[56] http://www.cws-scf.ec.gc.ca/egp-pde/

[57] Report of the Standing Committee of Finance, "Canada: Competing to Win" December 2006.

[58] Section 207.31 of the Act.

59 [2006] T.C.J. No. 149.

60 Ibid at para. 4.

61 Ibid at para. 13.

62 *R v. Bromley*, [2004] B.C.J. No. 481.

63 For example, see Technical Interpretation Letter 9700205, April 4, 1997 or Charities Information Letter CIL-1998-030,October 16, 1998.

64 Acorn Foundation v. M.N.R. (16 December 2005), Court File no. T-1784-05 (FCTD) [unreported].

65 CRA Technical Interpretation Letter 2005-0154751I7, October 21, 2005.

66 As discussed in R.B. Hayhoe, 'Federal Court Reviews CRA Undertaking Letter'(2006), 14:2 *Canadian Not-for-Profit News 13*.

67 For a more practical look at charity audit response, see Robert Hayhoe, "Canada Customs and Revenue Agency Charities Audits" (2003) 17 The Philanthropist 38.

68 Registered Charities Newsletter No. 27, Fall 2006.

69 *Ibid*.

70 *Ibid.*

71 Canada Revenue Agency, "Registering Charities and the Income Tax Act", RC 4108(E) 1204.

72 Canada Revenue Agency, "Auditing Charities — T4118", March 3, 2004.

73 Canada, Department of Finance, 2004 Budget, Budget Plan, March 23, 2004.

74 Subsections 189(6.2), and (6.3).

75 Subsection 189(6.2).

76 For a discussion about how the new Canadian sanctions should be applied with reference to American case law, see Robert B. Hayhoe and Marcus S. Owens, "The New Tax Sanctions for Canadian Charities: Learning from the US Experience," (2006), vol. 54, no. 1 Canadian Tax Journal, 57-86. See also Louis Tassé, "Policy Forum: The New Regime for Charities - Further Reflection," (2006), vol. 54, no. 1 Canadian Tax Journal, 211-220.

77 *Budget Implementation Act, 2004,No. 2*, S.C. 2005.c.19, ss. 38, 45.

78 *Supra note* 72.

79 *Acorn Foundation*, *supra* note 64.

80 Subsection 189(8) of the Act.

81 Subsections 165(1) and 168(4) of the Act.

82 Subsections 189(8.1), 168(4) and 172(3) of the Act.

83 Subsections 189(8) and 169(1) of the Act.

84 Subsection 188.1(4) of the Act.

85 Tax Court of Canada rules (General Procedure), SOR/90-688, as amended.

86 *Re Renaissance International v. Minister of National Revenue* (1982), 142, D.L.R. (3d) 539 (FCA).

87 As discussed in Patrick J. Boyle *et al.*, "Canada-U.S. Boundary Issues for Cross-Border Charitable Activities" *Taxation of Exempts* (November/December 2006) 129.

88 *Bayit* Lepletot v. Canada (Minister of National Revenue), [2006] F.C.J. No. 505.

89 G.H.L. Fridman, *The Law of Agency*, 7th Ed. (Toronto: Butterworths, 1996) at 216 and Cameron Harvey, *Agency Law Primer,* 2nd Ed. (Toronto: Carswell, 1999) at 77.

90 2006 FCA 136, leave to appeal granted [2006] S.C.C.A. No 206.

91 (1984), 13 DLR (4th) 491 (Ont. Div. Ct.).

92 Subsection 248(1) "Registered Canadian Amateur Athletic Association", 118.1(2), 110.1(2), and Regulation 3501.

93 A.Y.S.A. at para. 20.

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