THE TAX COURT OF CANADA

CHARITY SUSPENSION POSTPONEMENTS UNAVAILABLE?

International Charity Association Network v. The Queen
2008 DTC 2314

KEYWORDS: CHARITIES ■ REGISTRATION ■ SANCTIONS

On January 3, 2008, the Tax Court of Canada dismissed an application by the International Charity Association Network (ICAN) for postponement of a suspension of its tax-receipting privileges. ICAN had received a notice of suspension from the CRA in November 2007, and it had filed a notice of objection to that suspension. It then applied to the Tax Court under subsection 188.2(4) of the Act for a postponement of the suspension pending the outcome of its notice of objection. The Tax Court denied the application.

By denying this application, the Tax Court appears to have set an unfortunate precedent with respect to applications for postponement under subsection 188.2(4). The court interpreted the test for obtaining a subsection 188.2(4) postponement order in a manner that makes it exceedingly difficult for charities to acquire what should be a relatively accessible order. Because a year-long suspension, in practical terms, spells death for most charities, it is important for registered charities to be able to continue issuing receipts pending the resolution of their disputes with the CRA. However, this decision suggests that charities may have considerable difficulty in staving off their demise if the CRA decides to suspend their receipting ability.

Facts and Decision

ICAN operated a program in which it received funds and donations in kind of food, household goods, and other items for use in its own activities and for distribution to other charities. It operated this program on a large scale, in part with the assistance of tax-shelter promoters. The CRA audited ICAN in 2007, apparently suspecting that ICAN was operating solely as part of a tax-shelter program.

On November 21, 2007, pursuant to subsection 188.2(2), the minister of national revenue suspended ICAN's authority to issue tax receipts on the basis that (1) ICAN failed to maintain proper books and records, and (2) ICAN failed to provide records or provide access to records to the tax authority, contrary to subsections 230(2), 231.1(1), and 231.2(1) of the Act. The CRA claimed that ICAN had failed to

provide it with access to records related to receipts issued for a total of approximately $550 million. It also claimed that ICAN had failed to justify expenditures that totalled approximately $270 million. The suspension was for a period of one year and was scheduled to commence on November 28, 2007. Although the matter was not directly an issue on this motion, the CRA also issued a notice of intention to revoke ICAN's charitable registration on December 3, 2007.[17]

On November 23, 2007, ICAN filed a notice of objection to the suspension, declaring that it had attempted to comply at all times both with the record-keeping rules and with the rules regarding cooperation during an audit. It claimed that it had responded to questions from the auditor and had made records available for review by the CRA. It then filed an application under subsection 188.2(4) for an order postponing the suspension.

The Tax Court of Canada held that the postponement application under subsection 188.2(4) was essentially an application by the charity for an interlocutory injunction. Thus, the court held that in order to justify its postponement application, ICAN had to satisfy the three-part test for an interlocutory order set out by the Supreme Court of Canada in *RJR-MacDonald Inc v. Canada (Attorney General)*.[18] In other words, ICAN was required to demonstrate: (1) that there was a serious question to be tried, (2) that it would suffer irreparable harm if the injunction was denied, and (3) that the balance of convenience favoured the granting of the injunction.[19]

The Tax Court was prepared to find that ICAN had raised a serious question to be tried.[20] It was clear, however, that the court was influenced by the seriousness of the claims made against ICAN in the affidavit of the CRA's auditor, and it believed that the CRA had a strong case. The court held that ICAN had not proved that it would suffer irreparable harm if its receipting powers were suspended.[21] It particularly emphasized the lack of supporting evidence from ICAN's member agencies about how their ability to operate would be affected by ICAN's suspension. Finally, the court held that the balance of convenience favoured the CRA. It stated that the public's confidence would be harmed if the CRA was unable to administer the charities provisions of the Act and ensure compliance in the public interest. For these reasons, the court dismissed ICAN's application.

Analysis of the ICAN Decision

Several aspects of the court's decision in *ICAN* are potentially troubling. In considering the factors relevant under the *RJR-MacDonald* test and in placing the onus on the

17 See the decision of the Federal Court of Appeal refusing to postpone publication of ICAN's notice of revocation in the *Canada Gazette* in *International Charity Association Network v. MNR*, 2008 FCA 114.

18 [1994] 1 SCR 311.

19 *International Charity Association Network v. The Queen*, 2008 DTC 2314, at paragraph 57 (TCC).

20 Ibid., at paragraph 62.

21 Ibid., at paragraph 67.

charity to justify a postponement order, the court interpreted and applied subsection 188.2(4) in a manner that severely limits the subsection's availability to charities faced with a suspension. We believe that the Tax Court's interpretation is at odds with the purpose for which subsection 188.2(4) was enacted. In the sections that follow, we address both the procedural and the substantive aspects of the *ICAN* decision.

Purpose of Intermediate Sanctions

The Supreme Court of Canada has noted on more than one occasion that tax legislation, like all other legislation, is to be given a modern purposive interpretation.[22] As Gonthier J stated in *Québec (Communauté urbaine) v. Corp. Notre-Dame de Bon-Secours*,

> [T]here is no longer any doubt that the interpretation of tax legislation should be subject to the ordinary rules of construction. . . . Driedger fittingly summarizes the basic principles: ". . . the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the objective of the Act, and the intention of Parliament." The first consideration should therefore be to determine the purpose of the legislation, whether as a whole or as expressed in a particular provision.[23]

Thus, when interpreting the test for an application under subsection 188.2(4), it is important to bear in mind the purpose for which the intermediate sanctions—including the suspension power in subsection 188.2(2)—were initially created. Subsection 188.2(2) was introduced in the 2004 Budget along with a collection of other intermediate penalties for non-compliance with various rules relating to charities under the Act.[24] These measures were intended to provide forms of sanction that would encourage charities to correct any practices that were non-compliant with the Act in such a way that would allow the charities to continue operating. The sanctions were intended as a more nuanced alternative to deregistration, which was the only penalty available to the CRA when faced with non-compliance by a charity before the sanctions were introduced.

Some insight into the problems addressed by the 2004 amendments can be gained by considering the 2003 report of the Voluntary Sector Initiative Joint Regulatory

22 See *The Queen v. Canada Trustco Mortgage Co.*, [2005] 2 SCR 601, at paragraph 10; *Mathew v. The Queen*, [2005] 2 SCR 643, at paragraphs 40-43; and *Euro-Excellence Inc. v. Kraft Canada Inc.*, 2007 SCC 37, at paragraphs 2-3.

23 [1994] 3 SCR 3, at 17.

24 For a more detailed discussion of these intermediate sanctions, 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; and Susan M. Manwaring and Robert B. Hayhoe, "Charities Update: 2004 Budget Proposals," in *Report of Proceedings of the Fifty-Sixth Tax Conference*, 2004 Conference Report (Toronto: Canadian Tax Foundation, 2005), 8:1-35.

Table (JRT), on which the 2004 amendments were based.[25] The JRT was formed by the federal government in 2000 to make recommendations to improve the regulatory processes that applied to the charitable sector. One of its principal concerns was with the inadequate state of the measures available to deal with tax non-compliance by charities.

The JRT report noted that deregistration was unduly severe and inflexible as a tool for encouraging charities to comply with the Act.[26] The JRT emphasized the harshness of this penalty because it entailed not only the loss of a charity's ability to issue official donation receipts, but also the loss of the charity's tax-exempt status, as well as possible liability to pay a revocation tax equal to the value of the charity's remaining assets at the time of revocation (less legitimate expenses and payments to other charities).[27] The report also noted that non-compliance by charities can take many forms and that only a small percentage of incidents justify revocation. Different sanctions were needed for different forms of non-compliance, and some discretion had to be available to tailor disciplinary action to the circumstances of each case.[28] Thus, the report recommended intermediate sanctions as a graduated system of penalties to replace deregistration as the only means of penalizing non-compliance.[29]

Intermediate sanctions, in other words, were introduced as answers to the flaws inherent in deregistration, at least to the extent that deregistration was the sole penalty available. The principal failings of the deregistration penalty were its severity, the lack of discretion built into it, and its finality, which afforded charities no opportunity to correct non-compliant activities. The intermediate sanctions were intended to allow the CRA greater discretion in tailoring penalties to particular situations, and to afford greater opportunity for corrective behaviour on the part of charities. Deregistration was to become a tool of last resort, used only when all other compliance measures had failed.

Courts should be mindful, when reviewing the application of these sanctions, that their primary purpose is corrective and that they should be administered cautiously as they escalate in severity. A corollary of this concept is that charities must be given readily accessible recourse when faced with intermediate sanctions, particularly as the sanctions become more severe. The JRT report emphasized the need for safeguards to ensure that the penalties are applied properly:[30]

25 Canada, Voluntary Sector Initiative (Joint Regulatory Table), *Strengthening Canada's Charitable Sector: Regulatory Reform* (Ottawa: Voluntary Sector Initiative, 2003) (online: http://www.vsi-isbc.org/eng/regulations/reports.cfm).

26 The JRT noted the existence of other specific penalties for the misuse of cultural and ecological property and for gifts between charities designed to cover up a failure to meet the disbursement quota, but it noted that these penalties were rarely used in practice: ibid., at 88.

27 Ibid. The provisions allowing for the imposition of the revocation tax are found in section 188.

28 Ibid., at 93.

29 Ibid.

30 Ibid., at 93 and 95.

> In developing our proposals, we have consequently placed heavy reliance on the discretion of the regulator to produce an effective and just outcome. . . .
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> However, this discretion cannot be unfettered. In some places, we are suggesting a role for the ministerial advisory group. More importantly, given the powerful tools we are proposing be placed in the hands of the regulator, it is essential that charities have an accessible recourse system. *We do not believe the new intermediate sanctions we are recommending (suspension of qualified donee status and suspension of tax-exempt status) should be introduced without adequate recourse in the form we have recommended.*[31]

This philosophy should inform the interpretation of the test for a postponement order under subsection 188.2(4). Postponement applications are a form of recourse available to charities against the suspension power in subsection 188.2(2). Given the severity of a year-long suspension, which is apt to eliminate a charity's ability to operate, provisions that offer recourse against such a sanction should not be interpreted narrowly.

Procedural Aspects

The JRT's point regarding the need for charities to have readily accessible recourse when faced with intermediate sanctions raises an important aspect of postponement applications under subsection 188.2(4). A charity in an application for postponement is generally at a procedural disadvantage because it has limited time available to seek postponement before the suspension takes effect (seven days from the mailing of the notice). It therefore has only limited time to prepare a response to the substance of the CRA's allegations (which the CRA has had ample time to prepare). In particular, the charity operates under time constraints when collecting evidence and preparing affidavits in support of its application and in response to the allegations made against it. Any decision on an application for postponement should take into account the limited time available to the charity to respond, and should temper the charity's evidentiary burden accordingly. Unfortunately, this did not happen in *ICAN*.

Interestingly, the Tax Court acknowledged the procedural difficulties that charities face in seeking to appeal a suspension. In a note following his decision on the application, Rip J stated:

> However, a charity seeking to have its suspended receipting privileges restored faces a relatively lengthy delay before the situation may be resolved. The suspension under section 188.2 is for a maximum of one year. Subsection 188.2(4) deals only with a postponement of a portion of the period of suspension. For the suspension period to be cancelled, assuming the suspension is confirmed on objection, the charity would have to file an appeal. Unless the charity invites the Minister to immediately confirm the suspension, as suggested by respondent's counsel as one way of speeding up the process, it would take at least 91 days before the charity could appeal the suspension to this Court and then further delays would transpire until a reply to the notice of appeal

31 Ibid., at 95 (emphasis in original).

> is filed and discoveries are held before the appeal is heard. Ms. Schusheim, appellant's counsel, estimated that it could be close to the one-year suspension period before the appeal is disposed of. And if the charity puts its books and records in order, say 3 months after suspension, the time to have the suspension cancelled when the year is even shorter, unless, of course, the CRA consents to the cancellation.
>
> Parliament may wish to consider a summary procedure permitting a charity to contest a suspension.[32]

In our view, precisely such a summary procedure has been developed by Parliament and should have been employed in this case. Once a charity has been mailed a notice of suspension under subsection 188.2(2), there is a seven-day delay before the suspension begins.[33] A charity should be able file its notice of objection to the suspension as well as its application for postponement within this seven-day period. As a result of the serious effects of a suspension on a charity's ability to function, a preliminary postponement (perhaps for a month) should generally be granted to give the charity time to prepare a full response *before the suspension takes effect*. A charity should not be forced into an immediate appeal on the merits of the suspension in order to obtain an initial postponement.

This was not the procedure followed in *ICAN*, and the effects of this procedural difficulty appear to have directly influenced the result in this case. In *ICAN*, the Tax Court's decision appears to have been influenced by an assessment of the cases put forward by ICAN and the CRA. In particular, the court's dissatisfaction with the supporting materials presented by ICAN and its preference for the affidavit of the CRA's auditor seem to have had a considerable impact on its decision to deny the application. In deciding the motion on these grounds, the court failed to recognize the time constraints under which ICAN prepared its application, and it denied ICAN any form of temporary summary recourse that would have afforded it time to make a full answer. This approach seems inconsistent with the JRT's emphasis on the need for readily available recourse for charities, the effect of which should be to delay the imposition of the sanction.[34] The tools to provide for summary recourse, at least on a temporary basis, are available under subsection 188.2(4), and it would have been preferable if they had been applied in this case.

Application of Interlocutory Injunction Test

As noted above, the court was prepared to equate a postponement application under subsection 188.2(4) with an application for an interlocutory injunction, which requires the application of the three-part test from *RJR-MacDonald*. With respect, we question aspects of the court's analysis under each element of the test; we set out our reasoning below.

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32 Supra note 19, at note concluding case.

33 Paragraph 188.2(3)(a).

34 JRT report, supra note 25, at 103.

Serious Question To Be Tried

In *RJR-MacDonald*, the Supreme Court of Canada held that the first element of the test for obtaining an interlocutory injunction was intended to be a low hurdle.[35] The applicant does not need to prove its substantive case on the merits, nor must it prove that victory on the merits is even likely. It must demonstrate only that it has raised a "serious question to be tried," which merely requires proof that its case is not frivolous or vexatious.

The Tax Court was "prepared to find that there is a serious question to be tried."[36] Given the potential impact of suspension on a charity's operations, and in light of the concerns emphasized by the JRT about the need for recourse for charities that face sanctions, once a court finds that a serious question exists, an application for postponement should generally be granted. This procedure would recognize the need among charities for summary recourse when confronted with a notice of suspension.

It is noteworthy that when analyzing this element, the court seems to have been influenced by a preference for the CRA's evidence over that of ICAN. The court was clearly concerned about the seriousness of the CRA's allegations and the picture of ICAN's activities painted in the affidavit of the CRA's auditor. Here, we see the unfortunate effects of the procedural disadvantages that prevented ICAN from having adequate time to prepare a full answer. This situation raises the concern that all the CRA must do is put forward serious allegations of non-compliance in order to make it very difficult for a charity to meet the test for relief under subsection 188.2(4).

Irreparable Harm

The court stated that the onus of proving irreparable harm is on the applicant seeking the injunction.[37] While this burden of proof is the one in applications for interlocutory injunctions, applications under subsection 188.2(4) should arguably be treated differently. In practical terms, when the Crown issues a notice of suspension alongside a notice of intent to deregister, as it did in this case, it is actually seeking to use the suspension as an interlocutory injunction in advance of revocation. Because the Crown is able to obtain a suspension with minimal notice to the charity, the suspension is equivalent to an ex parte interlocutory injunction. Since the application for postponement is the first proceeding in which the charity has the opportunity to contest the suspension and since the Crown has adequate time to prepare its opposing argument in advance, we submit that the onus should be on the Crown to establish the need for an immediate suspension.

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35 Supra note 18, at 335-38. The court derived the formulation of this element from the decision of the House of Lords in *American Cyanamid Co. v. Ethicon Ltd.*, [1975] AC 396, which held that previous cases requiring proof of a "strong prima facie case" imposed too stringent a standard on applicants for interlocutory relief.

36 Supra note 19, at paragraph 62.

37 Ibid., at paragraph 64 (citing *Eli Lilly and Co. v. Novopharm Ltd.* (1996), 69 CPR (3d) 455 (FCA)).

If the onus remains with the charity, however, the charity's evidentiary burden in demonstrating irreparable harm should be low. It faces the same evidentiary difficulties in proving irreparable harm as it does in trying to establish that the merits of its case raise a serious question to be tried. It should be open to a court to find in favour of an applicant charity, provided that the charity raises a minimum of evidence concerning the potential impact of the suspension on its operations. Unfortunately, this did not happen in *ICAN*. The Tax Court's decision to find against ICAN on the question of irreparable harm was based in large part on the absence of affidavit material in support of ICAN's claim that its member organizations would suffer harm if its receipting privileges were suspended.[38]

This case raises another point regarding the irreparable harm test. When assessing the effects of a suspension, the court should be permitted to consider how a suspension would affect the beneficiaries of the charity's activities. Under subsection 149.1(1) of the Act, a charitable organization is defined as an organization that devotes all of its resources to charitable activities. It is, in other words, an organization that exists for the benefit of members of the public and society at large. Thus, when assessing the harm that will flow from the suspension, a court should take into account the effects of the suspension on those who depend on the charity's support. Under the balance-of-convenience test, a public authority may refer to the harm that could befall the general public when the authority assesses the harm that it itself might suffer. It seems logical, therefore, that a charity registered with the government as an organization existing for the public good should be permitted to make a similar reference to the harm that might befall its public beneficiaries.

Balance of Convenience

At this stage of the test for an interlocutory injunction, the court considers not only the potential harm to the applicant if the injunction is denied, but also the harm that may befall the respondent if the injunction is granted.[39] These competing interests must be balanced against one another to determine which party stands to suffer the greatest harm. Because the exercise involves balancing the harms that may be suffered by both parties, the test has been dubbed as the "balance of inconvenience."[40]

On this question, the court noted that if the CRA was unable to impose an immediate suspension, the public interest would be harmed by a loss of public confidence in the CRA as a regulator of charities.[41] The court held that because the CRA is a

38 Ibid., at paragraph 67. To add insult to injury, the Federal Court of Appeal relied on the fact that ICAN's receipting privilege had already been suspended in concluding that there would not be irreparable harm if ICAN's deregistration was not stayed pending its appeal. Supra note 17, at paragraph 9.

39 Supra note 19, at paragraph 71.

40 Ibid., at paragraph 7.

41 Ibid., at paragraph 72, citing *Attorney General of Canada v. Fishing Vessel Owners' Association of BC*, [1985] 1 FC 791, at 795 (FCA).

public authority, the public interest can be considered as a factor in determining the balance of inconvenience.

With respect, we believe that the court erred in ascribing to the CRA the role of protector of the public interest as a regulator of charities. In the context of the constitutional division of powers, the CRA is a federal taxing body; it does not regulate charities for the benefit of the general public.[42] On the contrary, section 92(7) of the Constitution Act, 1867 gives the provincial governments jurisdiction over the regulation of charities within the provinces.[43] The CRA's authority is limited to the regulation of matters related to the tax-exempt status of registered charities.[44] Thus, the CRA does not protect the public interest by controlling the behaviour of charities or by restraining general abuses by charities; indeed, such an action would be ultra vires any federal agency. Moreover, to the extent that the CRA seeks to regulate the activities of charities in the public interest, it acts outside its constitutional mandate, even if its actions are described as having an ostensible tax purpose.

The CRA appears in this case to have been engaged in a colourable attempt to prevent general abuse by ICAN. The ostensible grounds for the suspension were ICAN's failure to maintain adequate records and failure to comply with audit requests for information. However, many of the CRA's arguments suggest that the agency was attempting to shut ICAN down for misuse of funds and general abuse of the taxation system through participation in tax-shelter programs. Furthermore, the Tax Court appears to have accepted these purposes as a valid exercise of the CRA's mandate in assessing the question of the balance of convenience. The court stated that the public interest in allowing the CRA to regulate charities was at stake, and that it should not "handcuff" the CRA in its function as public protector.[45] For the constitutional reasons noted above, these considerations should not have provided a basis for a finding of potential harm to the CRA because it is not the CRA's role to protect the general public from abuses by charities. This role belongs to the provincial attorneys general.

Furthermore, in holding that a public authority always has an interest in maintaining public confidence, and that this interest is always relevant in assessing the balance of convenience and irreparable harm, the Tax Court has stacked the deck in favour of the CRA in all future applications under subsection 188.2(4). The court's holding suggests that the balance of convenience will favour the CRA almost by definition, particularly in light of the difficulties that charities will encounter in preparing

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42 Patrick J. Monahan and Elie S. Roth, *Federal Regulation of Charities: A Critical Assessment of Recent Proposals for Legislative and Regulatory Reform* (Toronto: York University Press, 2000).

43 Under section 92(7) of the Constitution Act, 1867, 30 & 31 Vict., c. 3 (UK), the provincial government has jurisdiction over "[t]he Establishment, Maintenance, and Management of Hospitals, Asylums, Charities, and Eleemosynary Institutions in and for the Province, other than Marine Hospitals."

44 Under section 91(3) of the Constitution Act, 1867, ibid., the federal government has jurisdiction over "[t]he raising of Money by any Mode or System of Taxation."

45 Supra note 19, at paragraph 78.

evidence of harm to themselves. Parliament cannot have intended such a result when it introduced subsection 188.2(4).

Conclusion

The purpose of subsection 188.2(4) is to provide a ready means of recourse for a charity faced with a notice of suspension. The subsection is intended to provide a counterbalance to the relatively severe effects of a suspension on a charity's operations. It should be interpreted in accordance with this purpose, which suggests that a postponement should be readily available, at least in the short term, to enable charities to respond to the allegations founding that support a notice of suspension. Unfortunately, the Tax Court's decision in *ICAN* sets a precedent that may make it exceedingly difficult for charities to obtain a postponement order under subsection 188.2(4). This is a regrettable development, and we hope that courts in the future will decide such applications along different lines.[46]

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