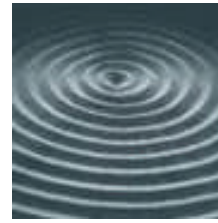
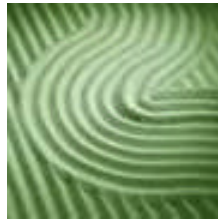


2500, 20 Queen St. West
Toronto, ON
Canada
M5H 3S1
Tel. 416.595.8500
Fax 416.595.8695
www.millerthomson.com



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Everything you ever wanted
to know but were afraid to ask
Robert B. Hayhoe
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CCRA AUDITS I – Robert B. Hayhoe

Everything you ever wanted to know, but were afraid to ask

Mr. Hayhoe's comprehensive coverage of the ins and outs of living through an audit by Canada Customs and Revenue Agency will be published by Canadian Fundraiser in five installments. Keep tuned – there are nuggets of information and recommendations here which may apply at some point to just about all our readers.

The Canada Customs and Revenue Agency (CCRA) has very extensive audit powers available to it in auditing registered charities. It is important for a charity and its professional advisors to understand how the CCRA uses those powers in order for the charity to know how to deal with a CCRA auditor.

It is also important, particularly for advisors to charities, to understand the current issues which concern the CCRA Charities Directorate and are therefore likely to give rise to an audit or cause difficulty during an audit.

CCRA charities audits

The focus of this series is CCRA Charities Directorate audits. It does not examine other kinds of CCRA audits that charities may be subject to, such as GST audits or payroll audits. Although the statutory authority for, and some of the approaches applied by the CCRA during these other audits, are similar, the issues that will preoccupy the CCRA during a Charities Directorate audit will obviously be quite different.

Although the CCRA Charities Directorate administers its own audits, in the recent past it used auditors from Consulting and Audit Canada to perform charities audits. This was generally not a good thing. In many cases, Consulting and Audit Canada auditors (whose usual job is to provide financial audit services to federal government entities) either did not have the knowledge necessary in order to permit them to find obvious violations of the *Income Tax Act* (the *Act*), or they fixated on irrelevant considerations.

Replacement of auditors

A recent trend has seen the replacement of Consulting and Audit Canada auditors with CCRA auditors from the local CCRA Tax Services Office. Unless the training provided to such auditors is dramatically better than that provided to Consulting and Audit Canada staff, it is difficult to see this as an improvement. Indeed, since some Consulting and Audit Canada staff have developed knowledge of charities, the changeover to local CCRA auditors may result in a decline in audit quality in the short term. As well, some CCRA tax services auditors may attempt to pursue their primary mandate, which is to maximize tax revenue in ways which are inappropriate to tax-exempt registered charities.

Nonetheless, time will tell – early anecdotal evidence suggests that CCRA Tax Services auditors may be better trained than their Consulting and Audit Canada predecessors. It is unfortunate that budgetary constraints (presumably) prevent the

CCRA Charities Directorate from using its own dedicated staff of charities auditors (as was the case in the past).

CCRA audit authority

The *Act* provides the CCRA with an escalating series of information-gathering tools. At the first level, the CCRA is given the authority pursuant to *section 231.1* to inspect any of a taxpayer's records that the *Act* requires to be kept. While the records which are required to be kept by a charity will be discussed later, note that the *Act* defines "record" very broadly to include any store of information rather than merely financial records.

Although the *Act* provides for revocation of a charity's registration for failure to co-operate with a CCRA auditor, this revocation provision is not likely to be applied unless the situation is particularly egregious, given the CCRA's other verification powers, which are described below.

Section 231.2 of the *Act* authorizes the CCRA to issue what is referred to as a "Requirement", i.e., a requirement to provide information to the CCRA. There are numerous circumstances that may cause the CCRA to issue Requirements in the context of a charity audit. On one hand, if the CCRA conducts an audit and finds that some record which ought to have been kept is not being made available, it can issue an official Requirement.

Intimidation tactic?

On the other hand, anecdotal evidence suggests that Requirements are sometimes used as an intimidation tactic by inexperienced auditors to demand records which are not required to be kept and which are irrelevant to a charity's compliance with the *Act*.

Finally, the CCRA can issue a Requirement which is driven, not by the charity's compliance issues, but by another party's tax issues. For example, if the CCRA decides to examine the validity of a gift by a charity's donor, it can issue a Requirement to the charity to provide information about the gift. The Court has recently confirmed that the CCRA's ability to issue a Requirement dealing with a third party is limited – a charity which receives such a Requirement should obtain specific legal advice before violating donor privacy.

It is important to ensure that a CCRA request for information really is a Requirement before complying with it. A practice seems to have developed at CCRA of sending out official letters requesting information, which do not meet the statutory definition of a Requirement.

Providing information to the CCRA pursuant to such a request (other than information relating to the registered charity's tax compliance) might result in liability to the subject of the request (since the protection of statutory compulsion would not apply).



Dealing with audits can be a landmine; tread carefully

Continued from page 8

The receipt of a CCRA Requirement by a registered charity is a very serious matter. The potential penalty for the charity is revocation of registration – a more realistic possibility in this context than at the initial audit stage. As well, if the Requirement is addressed to an individual staff member at a charity, that individual could be subject to fines and/or imprisonment if the Requirement is ignored.

Legal advice should be sought immediately when a Requirement is received, particularly given that the only way to attack a Requirement is to seek judicial review at the Federal Court Trial Division within 30 days of the date of service of the Requirement (assuming that the charity or staff person is not willing to ignore the Requirement and then defend against the revocation of registration or personal criminal charges on the ground that the Requirement was defective in some way).

Finally, the CCRA can also issue search warrants pursuant to section 231.3. The issuance of a search warrant is very serious and indicates the possibility that the CCRA is investigating criminal wrongdoing. In such circumstances, legal advice should be obtained immediately (on both a tax law basis and a criminal law basis).

CCRA audit philosophy

CCRA brings a particular philosophy to its audits. The Agency states that it audits charities to ensure that they are complying with the requirements of the *Act*. A useful way to think about CCRA charities audits is to bear in mind that the CCRA will seek to discover through its audit whether the charity is in both financial compliance and activity compliance.

Financial compliance refers to whether the charity is receipting properly and spending its resources properly and otherwise keeping proper financial records. Activity compliance refers to whether the charity's activities are in furtherance of its charitable purposes and otherwise in compliance with the tax law and the CCRA's administrative positions.

An audit of this kind requires examination of not only the financial records but also of a variety of other materials that reveal the activities of the charity and clarify the purpose for such activity, such as correspondence, reports, pamphlets, video recordings, etc. It could certainly be argued that neither Consulting and Audit Canada auditors, who are trained as financial auditors, nor CCRA tax auditors, who are trained to collect taxes, are well suited to this task.

The audit process endeavours to be confidential. As such, the CCRA is restricted from revealing to anyone, including the media and the charity's members, information that is obtained during an audit (including even whether an audit has occurred). It should be noted that the report of the **Voluntary Sector Initiative Joint Regulatory Table** (the *JRT Report*) considered relaxing the audit confidentiality rules (on the basis that charities,

unlike other taxpayers, have a public duty) before concluding that it would only recommend disclosure of the existence of a compliance action (such as an audit), if the action resulted in the application of serious sanctions.

CCRA audit selection

There is a variety of methods applied by the CCRA to select charities to be audited. First, the CCRA has in place a selection process that it insists is random, although it refuses to provide details as to how it works. (Arthur Drache has observed in "Audit Woes" (2002) 10:3 *Canadian Not-for-Profit News* 17, p. 19, that "the good news is that ... less than 1% of charities are audited annually. Indeed, it seems to us, having seen file after file with multiple audits, that they like to return over and over again to the same offices even when there has been a clean audit earlier. Maybe they just like the coffee." This is consistent with my experience.)

Second, carrying on certain types of activities that are perceived by the CCRA to be problematic or particularly open to noncompliance may trigger an audit.

Finally, a complaint brought against a charity will also trigger an audit by the CCRA. Any individual may request from the CCRA the constating documents, T2050 *Application for Registration* and any T3010 *Information Return* for any registered charity).

Quite frequently it is possible to find violations of the *Act* by a registered charity by performing a cursory review of its T3010 Information Return. Although not everyone's purpose in ordering and reviewing T3010s is nefarious, mischief makers who may be opposed to the charity's work may simply report a violation or perceived violation to the CCRA.

For example, the CBC's *Disclosure* program ran a special on December 4, 2001 which profiled an organization called **Charity Watch** (which was itself a registered charity) which allegedly specialized in investigating registered charities linked to progressive causes. In the *Disclosure* piece, Charity Watch and its principal, **George Barkhouse**, are given credit for leading the CCRA Charities Directorate to revoke the registration of such charities as the **Friends of Clayquot Sound**.

Robert B. Hayhoe is a charity lawyer with Miller Thomson, 20 Queen St. W., Ste. 2500, Toronto ON M5H 3S1, 416/595-8174, fax 416/595-8695, rhayhoe@millerthomson.ca, www.millerthomson.ca; this article was originally published in The Philanthropist, a journal published by the Agora Foundation with the assistance of the Charities Section of the Canadian Bar Association and the Canadian Centre for Philanthropy, Volume 17, No. 4, (www.thephilanthropist.ca) and was developed from a presentation at an October 18, 2002 conference in Vancouver sponsored by the Continuing Legal Society of British Columbia. Mr. Hayhoe editors Miller Thomson's Charity and Not-for-Profit Law Newsletter – complimentary subscriptions are available by sending an e-mail request to charitieseditor@millerthomson.ca.