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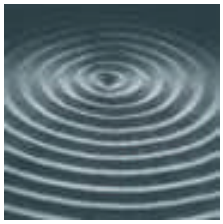

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A charity's responsibilities, privileges, faced with an audit

Robert B. Hayhoe

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CCRA AUDITS II – *Robert B. Hayhoe*

A charity's responsibilities, privileges, faced with an audit

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 Fund-Raiser*** *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 audit philosophy of a registered charity

An organization which is facing an audit should develop an audit philosophy to enable its staff to cope with the situation as well as possible. The CCRA auditor is neither friend nor foe. The auditor's proper goal should be to ensure that the subject organization is in compliance with the *Income Tax Act.* As such, the auditor should be treated with respect. This is especially true given that the auditor has significant ability to influence the tone and content of the audit report.

The *Act* requires an audit subject to provide "all reasonable assistance" to an auditor and makes it a specific offence (punishable by revocation of charitable registration) to "attempt to interfere with, hinder or molest any official doing or prevent or attempt to prevent an official from doing, anything that the official is authorized to do under this Act,". Thus, it is important for a charity to provide the auditor with the required information and access.

Income Tax Act record-keeping requirements

There are a number of difficult issues around the margin of what constitutes a record and how detailed record-keeping needs to be for tax purposes generally. However, this article will deal only with the issues in a charity-specific context.

Section 230(2) of the *Act* outlines the primary record-keeping obligation for a registered charity. It requires that:

Every registered charity and registered Canadian amateur athletic association shall keep records and books of account at an address in Canada recorded with the Minister or designated by the Minister containing

(a) information in such form as will enable the Minister to determine whether there are any grounds for the revocation of its registration under this *Act;*

(b) a duplicate of each receipt containing prescribed information for a donation received by it; and

(c) other information in such form as will enable the Minister to verify the donations to it for which a deduction or tax credit is available under this Act.

It is relatively clear that a charity must keep duplicate receipts and documents to support the details of its donations received. However, the scope of paragraph *230(2)(a)* is less clear. Essentially, this provision requires that a charity keep sufficient records to demonstrate that all of its activities have a charitable purpose. This requires that the charity exercise considerable discretion in deciding what records to keep. However, in all cases, a charity must not destroy records if it is specifically concerned that the particular activities dealt with in these records may be perceived as not being charitable. Such action could even constitute a criminal violation of the *Act.*

It should be noted that *section 230(4.1)* renders electronic data acceptable as a general matter. The Charities Directorate has also announced that it permits official donation receipts to be issued electronically (and therefore to be stored electronically).

Record retention requirements

Income Tax *Regulation 5800* states how long records of a particular nature must be kept by a registered charity. The *Regulation* stipulates that corporate records, including directors' and members' resolutions and minutes and all governing documents must be kept until two years after the registration of the charity is revoked (if ever). As a practical matter, this means that corporate records of a registered charity must be kept forever. As well, if a charity receives a gift from an individual subject to a trust condition or direction that requires that the capital of the gift be kept for at least 10 years, it is required that the

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Direct mail is no more dead than is the radio

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- the "shelf life" of direct mail as a fundraising tactic is going to be longer than many of us expected (including me)
- people who grew up before television still like paper – and they like to read
- is direct mail dead? Not by a long shot!

A final thought

It appears that print media (newspapers, books, magazines – and yes, direct mail) have survived the digital revolution quite nicely, thank you. There is a sizeable segment of our society that prefers paper and the printed word.

When television was introduced in the late 1940s and early 1950s, the pundits loudly pronounced the impending death of radio. I don't know about you, but our household owns more radios than televisions some 50 years later.

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Record-keeping requirements for nonprofits can be stringent

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document imposing the condition also be kept until two years after revocation of registration. Finally, duplicate receipts and supporting information must be kept for two years from the end of the year to which the receipt relates.

The time for which records required by paragraph *230(2)(a)* (records required to defend against revocation) must be kept is not dealt with specifically in the *Act*. However, the default record-retention requirement in the *Act* is six years from the end of the tax year to which the records relate.

Privilege

The concept of solicitor-client privilege is important in the context of CCRA audits. Certain kinds of communications between a solicitor and client are protected from the CCRA. Solicitor-client privilege encompasses all communications in which clients ask their lawyers for legal advice, a lawyer provides a client with legal advice, or a client asks someone else to provide information to the client's lawyer so that the lawyer can provide the client with legal advice. This privilege is Canada-wide, so a charity in one province which is advised by a lawyer in another province will still be protected by privilege.

It is important in dealing with privileged documents that the privilege not be waived inadvertently by disclosing the privileged documents' contents to a third party (other than an agent hired to assist with the provision of legal advice). This is easy to do when dealing with opposing counsel in a transaction or negotiation.

In contrast, there is no privilege between clients and their accountants. As a result, the CCRA can read, retain and use in an audit any communication sent between clients and their accountants. The same is true for any communication between consultants and their clients.

Claiming privilege

The *Income Tax Act* sets out a mechanism for claiming privilege during an audit. *Section 232* of the *Income Tax Act* provides that if a lawyer has documents in his or her possession that the CCRA seeks to obtain, the lawyer must seal the documents and the CCRA may ask a court to determine if the documents are in fact privileged. Notwithstanding that this is a fairly complicated procedure which requires going to court, depending on the contents of the documents, it may be worth taking the necessary steps to protect documents against the CCRA. While this provision does not specifically protect documents kept at the client's office during a CCRA audit, CCRA has indicated that the procedure described above would apply. Nonetheless, it is prudent to collect all privileged documents and send them to your lawyer, in order to enable him or her to take the steps set out in *section 232*.

In a recent decision, *R.* v. *Lavallee, Rackel & Heintz,* the **Supreme Court of Canada** considered whether *section 488.1* of the *Criminal Code* is constitutional. The relevance of this case in the context of CCRA audits of charities is that *section 488.1* sets out the statutory procedure to be used to evaluate a claim of solicitor-client privilege regarding documents seized from a lawyer's office pursuant to a search warrant and has many similarities to *section 232* in the *Income Tax Act*. The Supreme Court concluded that *section 488.1* does not meet its objective: to create a procedure which would result in reasonable searches and seizures of documents or other materials which might be covered by solicitor-client privilege and which are in the possession of a lawyer. In particular, the Court concluded that the provision unreasonably and unconstitutionally impairs solicitor-client privilege because it could result in privilege being lost (without the client whose privilege it is, knowing):

- from the inaction of the lawyer;
- from the fact that clients may, or even must, be named;
- that the seizure may be executed without notice to the client to whom the privilege belongs;
- from its strict time limits for application;
- from the absence of residual discretion in the judge hearing the application to make findings of privilege outside those made in accordance with *section 488.1*; and
- from the possibility that the government may, with leave, have access to the materials prior to a judicial determination of the presence or absence of solicitor-client privilege.

As a result, the Court held that *section 488.1* infringed *section 8* of the *Canadian Charter of Rights and Freedoms* and could not be saved by *section 1* of the *Charter*. The Court developed a detailed common law procedure for law office searches. Any charity which is asked to reveal privileged documents should immediately contact its lawyer for specific advice in responding to the request or the Requirement or search warrant.

While there are minor differences between *section 488.1* of the *Criminal Code* and *section 232* of the *Income Tax Act,* it appears that *section 232* is unconstitutional because all of the deficiencies identified by the Supreme Court of Canada in the context of *section 488.1* of the *Criminal Code* are also present under *section 232* of the *Act*.

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