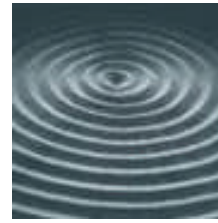
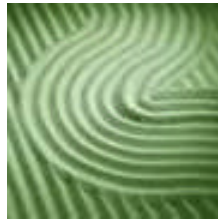


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How it works: cost of  
non-compliance may  
be de-registration  
Robert B. Hayhoe  
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## CCRA AUDITS III – Robert B. Hayhoe

### How it works: cost of noncompliance may be de-registration

*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.*

#### Audit notification

Normally, a charity will be notified of an impending audit through a letter or a telephone call from the CCRA or the assigned auditor. When the first contact is made, it is important that a charity select a date for commencement of the audit that is somewhat removed, as it needs sufficient time to contact its professional advisors and to plan and prepare for the audit. As the CCRA acknowledges, many charities are run by volunteers and therefore need time to assemble the records necessary to avoid wasting the auditor's time.

Except in very unusual circumstances, it is important that a charity obtain only the advice, and not the representation, of its lawyer. If the CCRA auditor is confronted with a lawyer as the audit is beginning, the auditor may assume that the lawyer has been retained because there is something worth hiding. It is suggested, therefore, that charities consult with a charity tax lawyer before the audit but the CCRA should not be aware of the lawyer's involvement until after the audit report is issued.

#### Audit parameters

It is advisable for a charity to discuss the parameters of the audit with the CCRA auditor prior to the audit. Although the CCRA has a specific set of rules for audits of large corporations allowing the parties to pre-agree on the audit scope, there is no comparable specific set of rules for charities. (The Charities Directorate did propose a form of agreement on audit scope but the draft has been removed from the CCRA's web site. I understand that there was substantial opposition within the CCRA to such things as the CCRA agreeing not to re-audit the same organization for a period of time.) Nevertheless, it is often possible to agree in advance on what is going to be discussed and whether the audit is a specific audit or a general audit. An auditor may be convinced of the benefit of arranging these details before the commencement of the audit by suggesting that the audit can thereby proceed in a more organized and efficient manner. After the initial conversation with the auditor, a letter should be sent either by the charity or the auditor confirming in writing any agreement reached with the auditor. The letter should confirm the date on which the audit will commence, the documents that will be examined by the auditors, who will represent the charity, and that a representative of the charity (often its chief financial officer) will be available on the days of the audit to answer any questions.

At the same time as preparatory discussions with the auditor are proceeding, the charity should be conducting its own pre-audit

review. The charity should request from its charity tax lawyer a review of all tax and other legal issues that may arise during the audit and a review of what the exposure may be in relation to those legal issues. For instance, if the charity is involved in foreign activities, the lawyer should ensure that the arrangements with the foreign charities that partner with the domestic charity comply with the CCRA's requirements regarding foreign activities.

The charity should also consider requesting that its accountant examine its financial records before the audit. Since there is no privilege available for discussions with or advice received from accountants, charities should be cautious when requesting compliance advice from an accounting professional because the CCRA auditor will be able to review that advice and any criticism it contains. Instead, a charity might request that its accountant review the financial books and communicate any problems to the charity's lawyer for the purpose of assisting the lawyer in providing legal advice about the audit. If this approach is followed and is not a sham, it is likely that the accountant's factual review would be privileged, because it would be a component of legal advice.

To the extent that this review discloses any areas of noncompliance, consideration should be given to possible ways of bringing the charity into compliance prior to the audit. In some cases, this can be done easily (collecting and entering missing accounting data), while in other situations, it can be difficult or impossible. Particular care should be taken to avoid inappropriate backdating of missing agreements. While it might be appropriate to prepare a document as evidence of an agreement which was already in place, such a late-prepared document should likely be executed with a current date but with an earlier effective date.

#### Audit day

As discussed earlier, the *Act* requires in *section 231.1* that a party that is being audited give all reasonable assistance to the auditor. Thus, a charity's staff should be pleasant and civil with the auditor. However, it is important to limit staff access to the auditor as much as possible, especially if particular staff members are hostile to the idea of being audited or if they do not understand the seriousness of being audited. One person should be assigned to deal with the auditor directly, including answering any questions and providing documents. (By audit day all privileged documents should have been removed or otherwise adequately protected.)

Charities being audited sometimes mistakenly view the presence of a CCRA auditor as an opportunity for free professional advice and ask the auditor questions about particular areas of charity tax law. When a staff member of a charity asks a question about a particular subject, the auditor will almost certainly look very carefully for noncompliance in that area. Neither a



## Pointers on how to act when the auditor comes knocking

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charity being audited nor its staff have any responsibility to raise issues with the CCRA auditor which have not been identified by the auditor. Indeed, it might even be argued that a charity and its individual representatives have a fiduciary obligation *not* to raise issues with the CCRA and thereby imperil the organization's charitable registration and assets.

If the selected representative of the charity is asked a question that he or she is unable to answer or is concerned about answering properly, the representative should know that the auditor should be asked to put the question in writing for later response. Subsequently, the representative can find the answer and craft the proper response (with the assistance of counsel).

### Audit findings

After the audit is completed, the CCRA used to take a long time before reporting its findings to the charity. In the recent past, it was not unusual for an audit report not to be issued for many months or years, or even never. Charities which did not hear from their CCRA auditor for many years reasonably assumed that the auditor had lost the file or had closed the file without sending a final report. Since the transfer of charity audit responsibility to CCRA Tax Services Office auditors, this situation of appalling delay seems to have improved.

When an individual auditor has completed his review, he will often arrange an audit meeting to discuss the report. A draft report will be provided by the auditor that will set out the objections (if any) to the activities of the charity. If possible, the charity's representative should explain to the auditor why the issues are not as problematic as they might appear to the auditor. Objections and corrections should be articulated before the final field audit report is produced.

Once the field auditor's report has been drafted, it is forwarded to the Charities Directorate for review and consideration of appropriate compliance action.

Assuming that the Directorate eventually reviews the field audit report, there are a number of possible outcomes. The first is a confirmation-of-compliance letter, whereby the Directorate confirms that the audit disclosed no areas of noncompliance. The second possibility is an education letter wherein the Directorate indicates that, although the auditor discovered minor areas of noncompliance, the Directorate does not intend to take any compliance action other than the audit letter which is designed to educate the charity on ways to correct the problems identified.

If the audit discloses major areas of noncompliance, the Directorate will write to the charity requesting that the charity or its representatives undertake in writing to remedy the situation and will generally require that the undertaking be relatively detailed. The CCRA will revisit the charity to follow up on compliance, so it is important to be sure that the given undertaking is one with which the charity can comply.

If the Charities Directorate believes that the noncompliance by the charity is serious enough to justify revocation of registration, the Charities Directorate will issue an administrative fairness letter which is a proposal of revocation of registration. As a practical matter, while the issuance of an administrative fairness letter should be taken very seriously by a registered charity, it does not necessarily mean that the registered charity is actually going to have its charitable registration revoked. In many cases, the CCRA uses the administrative fairness letter as a means of communicating to the registered charity the seriousness with which the CCRA views the particular noncompliance issue. It may well be possible to respond to an administrative fairness letter in a way which results in the issues being resolved through the use of undertakings.

If the problem that the CCRA has raised was raised previously and previous undertakings were not fulfilled, or if the charity is committing a particularly serious violation (perhaps one involving fraud), the charity's registration may be revoked.

### Legal representation and submissions

Once an auditor identifies serious noncompliance issues in the course of a field audit review meeting, the charity should immediately (assuming that it has not already done so) seek legal advice. If the lawyer agrees that the issues raised by the auditor are indeed serious, it will probably be appropriate for the charity to change its approach to the issue to bring it into compliance with the *Act* and/or the CCRA's administrative position on the issue (without waiting for the official CCRA Charities Directorate reporting letter). It may even be appropriate (even prior to being contacted by the Charities Directorate) to initiate immediate discussions with Charities Directorate outlining the measures proposed to move the charity into compliance.

As a general rule, if CCRA Charities Directorate issues anything other than a confirmation of compliance, the communication should be provided to the charity's lawyer immediately, for comment and advice. At this time, it is probably appropriate for the lawyer to deal directly with the Charities Directorate on any issues which arise. The charity's lawyer has the advantages of superior knowledge (hopefully), the ability to approach the situation from a less emotional standpoint, and the ability to protect the consideration of the issues with privilege (enabling the lawyer to develop an analysis of the problem and perhaps protect any weaknesses of the submission or the underlying situation from the CCRA).

Revocation of registration is the only penalty available for most violations of the *Act* that a charity may commit (pending implementation of the recommendations of the JRT Report). Pursuant to the *Act*, registration can be revoked for, among other things, ceasing to comply with the requirements for registration, improper receipting, and interfering with an audit. The most significant factor is ceasing to comply with the requirements for registration. →

## Consequences of de-registration are profound

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Once charitable registration is revoked, an organization faces many serious consequences. It becomes a taxable entity since it is no longer exempt as a nonprofit organization and will, therefore, be subject to the same taxation regimes as other entities. Also, the organization will no longer have the ability to issue tax receipts for donations. The organization will be charged a "revocation tax" which comprises an amount equal to the total market value of all assets owned by the organization 120 days before the notice of revocation was issued, the amount of any tax receipts issued after the date of revocation, and all amounts received from any other registered charity. A deduction is permitted for the total of the fair market value of all assets transferred by the organization to qualified donees after the date of revocation, all amounts paid with respect to reasonable expenses, any payments for debts of the organization, and any monies spent on charitable activities between the time of revocation and the time that the tax is paid. If persons other than qualified donees received money from the charity after the date of the revocation, they are also responsible for the payment of the revocation tax to the extent of the amount so received.

A prudent charity that intends to do something that may be regarded as being noncharitable by the CCRA, may consider establishing another charity so as to be prepared to transfer its assets quickly (presumably the transferee would not be involved with the offending activity) in the event that registration is revoked. This is complicated planning and should only be carried out with professional advice.

If a registered charity actually receives notice of revocation of registration, the only official recourse is an appeal to the Fed-

eral Court of Appeal by way of a judicial review. This is a very daunting and expensive appeal process, especially since it is based on a frequently deficient CCRA Charities Directorate file record and no new evidence can be introduced without leave from the Federal Court of Appeal.

In some cases the filing of a Notice of Appeal with the Federal Court of Appeal moves the matter from a sometimes inexperienced CCRA auditor and CCRA Charities Directorate officer to more experienced CCRA Charities Directorate staff who are assisted by equally experienced Department of Justice tax counsel. Their involvement may result in a more sensible approach being taken by the Charities Directorate, with continued registration being the eventual result. As a result of the universal agreement of all participants that the current appeal structure does not work, there is a current proposal to replace judicial review at the Federal Court of Appeal with a real trial at the Tax Court of Canada.

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### FUNDRAISING VEHICLE

## Game board concept extended to individual format

**H**elpOnBoard, the company which offers an "opoly" style board game as a fundraising vehicle (*CF* February 28), has created a new and different board game tailored specifically to the educational as well as the fundraising needs of **Child Find Ontario**.

The *Safetyville* game is designed to teach children and their parents about child safety in an entertaining fashion. The goal is to sell 20,000 games and raise \$500,000 for Child Find's work.

Success of the program (as, of course, with most fundraising campaigns) hinges on finding sponsors to cover the costs of production and marketing. **CIBC** is currently on board, but the organization still needs several more Safety Participation Sponsors as well as media and retail sponsors.

A Safety Participation Sponsor gets a broad range of branding and recognition returns for its funding, but most of them involve an ongoing presence on the board itself and/or the packaging, which means the game can't go into actual production until the sponsor panel is complete, explains **Trish Derby**, Ex-

ecutive Director of Child Find Ontario.

The game has been designed and the content developed by staff and volunteers of the organization, but the sponsor solicitation is dependent on the work of board members "who of course have day jobs", she says, in particular President **Ian Couldridge**, whose relationship with HelpOnBoard management sparked initiation of the project in the first place.

"We really hope it flies," says Derby. "We'd hoped to have it ready for Christmas, but obviously we're not going to make that goal. But next June is our 20<sup>th</sup> anniversary, and May is Missing Children Month, so now we hope we can tie those events together with launching the game."

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