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Current issues: advocacy, foreign activities, terrorism

Robert B. Hayhoe

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Book explains ramifications of receiving and handling bequests

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als that charities are being ungrateful by asking too many questions, she clearly articulates that a charity not only has the right to make its presence known, but in fact has a fiduciary responsibility to do so.

Of great practical interest to charities, Chapters 3, 4, 5 cover legal fees, taxes, releases, costs, and accounting, and include a case study. These chapters are full of sound advice.

Most charities will be familiar with the request to sign a release, but Sweetmen points out that charities should not feel pressured to sign, especially if the charity has some unresolved issues about the administration of the estate. She states that the release relates to the estate administration and not to a beneficiaries entailment. Even if the release is not signed, the estate trustee is under an obligation to deliver the gifts that the Will provides. The charity should not feel obliged to sign even if the trustee incorrectly states that it will not receive distribution until it has signed the release.

Another very practical example relates to a common request by estate trustees to include an indemnity clause in the release. Sweetman issues a strong caution about this practice, stating that the charity should delete the clause, as it may potentially be incurring a liability of an unknown amount.

Legal proceedings

In the final chapter, *Estate Litigation,* we are presented with an excellent overview of the various factors involving legal proceedings relating to the Will or claims against the estate. For many charities, legal wrangling in estate settlements are becoming all too common. Sweetman asks: Should a charity be an active participant in litigation? The answer is not straightforward and involves many factors, not the least of which are the objects of the charity. In addition, the charity and the directors personally owe certain duties – the charity must ensure that it is informed and the directors must act in good faith and in the best interests of the organization.

Litigation is not an easy matter, but with knowledge comes confidence. The book has imparted that knowledge and hopefully those charities facing estate litigation will have the confidence to stand on their rights.

This is a book I would recommend. There is only one comment to be made. Sweetman admirably fulfills her stated purpose of providing guidance to charities in bequest management, but I would have liked the author to have spent more time on how charities can work with their living donors to prevent those problems that later on give rise to estate litigation. It is my firm belief that in matters of litigation, prevention is better than a cure.

All in all, the entire book makes a good read. It should be kept close at hand, as it will make a ready reference piece for those occasions when it is needed.

Bequest Management for Charitable Organizations, M. Jasmine Sweetman, Markham: Butterworths June 2003, 342 pages, $75. Endorsed by Canadian Centre for Philanthropy, discount for members. See www.butterworths.ca/bookinfo.php?pid=606 or www.fedpubs.com/subject/business/bequest_mgmt.htm, 416/860-1611, info@fedpubs.

CCRA AUDITS IV – *Robert B. Hayhoe*

Current issues: advocacy, foreign activities, terrorism

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.*

Current charity tax issues

There are a number of current audit concerns that both increase a charity's risk of being audited and are likely to be looked at carefully if a charity is audited for some other reason. If a charity is engaged in advocacy, is involved in foreign activity, provides grants to foreign charities, receives directed gifts, has received art donations, or carries on any business activities, it is more likely that it will be audited. I will address some of these current issues in outline (with the goal of raising questions, not of providing answers). There are also a number of other items like disbursement quota compliance that are always looked at in an audit, but which I will not outline here.

Political activities

As a matter of the common law, political purposes are not charitable at law. Attempts to lobby government or change public policy will not be characterized as charitable and organizations conducting such activities are ineligible for registration as charitable organizations. However, organizations that have purposes that are incidentally political are deemed as a matter of tax law to be charitable provided that they devote "substantially all" of their resources to charitable activities. Ancillary and incidental activities are specifically defined not to include activities which support a candidate for political office or a particular political party.

On the other hand, it can sometimes be very difficult to draw the line between political purposes and educational purposes.

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Foreign activities particularly sensitive areas to monitor

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The CCRA views this as a very contentious issue and looks very carefully at registered charities and applicants which carry on, or which propose to carry on, any political activities. The CCRA's policy guidance on the issue is also in some disarray. There is also currently significant agitation in the Canadian voluntary sector in favour of permitting pure advocacy organizations to become registered as charities. (And CCRA has clarified significantly its position with its new guidelines – ***CF*** September 30).

The CCRA is known to look very carefully at political activities when it audits charities. This has been a particular problem for British Columbia-based environmental charities and for some religious charities, particularly those that deal with the abortion issue.

Foreign activities/grantmaking

The carrying on of foreign activities by a Canadian registered charity is a complicated area which has caused difficulties for many registered charities. The CCRA's position on this issue has been neither consistent nor, at times, well communicated to registered charities. The result has been the revocation of the registration of a number of charities which thought in good faith that they were following the CCRA's policies.

As a condition of registration, a registered charity is required by *subsection 149.1(1)* of the *Income Tax Act* (Canada) to devote all of its resources "to charitable activities carried on by the organization itself". A deeming rule in *subsection 149.1 (6)* deems within limits that grants to qualified donees have been spent on a charitable organization's own activities. As a result, a charitable organization may not make grants for a charitable purpose unless the grants are made to a qualified donee.

Qualified donees are defined by *subsections 149.1(1)* and *118.1(1)* to include other registered charities, all levels of government in Canada, the United Nations, foreign universities customarily attended by Canadians, and foreign charities to which the federal government has made a gift in the past 12 months. (The list of foreign charities to which the federal government makes gifts is extremely short.)

Thus, a registered charity may only fund foreign charitable activities either through one of the very limited number of qualified donees or by carrying out its own foreign charitable activities. It is, however, possible for a registered charity to carry on its own charitable activities using one of a number of legal devices which essentially deem the foreign activities of others to be activities of the Canadian registered charity. Basically, a registered charity can either engage a foreign charity as its agent to carry on some particular task or can enter into a form of joint venture with the foreign charity for a particular purpose.

The approach of the CCRA to arrangements between Canadian registered charities and foreign entities has tightened considerably in recent years. As a result, there have been two recent decisions of the **Federal Court of Appeal** in which the court denied revocation of registration appeals brought by charities which had seen their registrations revoked for noncompliance involving foreign activities. The first of these was the *Committee for the Tel Aviv Foundation* vs *The Queen* and the second recent case was *Canadian Magen David Adom for Israel.* Since these cases are instructive on both substantive law and as descriptions of the CCRA's audit approach, I will outline them in some detail.

The Tel Aviv case

In *Tel Aviv,* Revenue Canada had audited the Canadian charity (the Committee) on a number of previous occasions and had consistently flagged the failure to control foreign activities carried out by the **Tel Aviv Community Foundation.** In fact, in 1995 Revenue Canada even threatened to deregister the Committee because it had violated the terms of its agency agreement with the Tel Aviv Community Foundation since the Committee could not demonstrate control of funds expended by its agent and did not have proper reports from its agent. To avoid deregistration after the 1995 audit, the Committee undertook to "conform strictly to the requirements of Revenue Canada, including the specific provisions of the agency agreement, which is still in force and effect". In 1999, the CCRA audited the 1997 year of the Committee and found the same record-keeping and control failures. The CCRA then issued notice of its intention to revoke the registration of the Committee.

The Committee appealed its deregistration to the Court of Appeal on the basis that the CCRA should not have considered compliance with the terms of the agency agreement but should instead have considered whether or not the relationship between the Committee and the Foundation met the legal test for agency at common law so that activities of the Foundation were, at law, activities of the Committee. The Court decided that, on the facts of the case, there was a violation of the requirement of the *Act* that a charitable organization carry on its own activities (because the Committee could not show that it had controlled or directed the activities of its agent, the activities were not carried out on its behalf.) Furthermore, the Committee was missing certain of the reports which it ought to have received from the Foundation and therefore could not meet the record-keeping requirements of the *Act.*

Strict compliance

This case demonstrates that for foreign activities to be carried on through an agency arrangement, strict compliance with the law is necessary, including the keeping of appropriate records in Canada. A Canadian charity which is using a foreign agent can rely on frequent written financial and operational reports to satisfy the requirement that the Canadian charity keep suffi-

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Terrorism/security questions also fraught with perils

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cient records to show that the activities carried on by its agent are charitable. However, this only works if the records are detailed and are actually kept by the agent and forwarded to the Canadian charity. As a practical matter, charities should also be advised to follow the CCRA's administrative position set out in CCRA Guide RC4106, "Registered Charities: Operating Outside Canada".

Another lesson which can be learned from this case is that while the CCRA may sometimes agree not to deregister a charity which fails to comply with the tax rules, the CCRA will be much less patient with a charity which was warned about the issue in a previous audit.

Magen David Adom case

Canadian Magen David Adom for Israel (CMDA) provided ambulances and other medical equipment to an affiliate in Israel (MDA). For a number of years (and through a number of Revenue Canada audits) Revenue Canada applied an internal policy which is referred to as its "charitable goods policy" to permit CMDA to transfer ambulances and medical supplies to MDA without the agency or joint venture agreements referred to above.

This policy (which was never disclosed by Revenue Canada to the public or even to the tax professional community) provided that where a Canadian registered charity transferred goods which are meant by their nature to be used only for a charitable purpose (like medical equipment) to an organization that will use the goods for such purpose, the transfer will be considered to be an example of the registered charity carrying on its own charitable activity.

Eventually CMDA was audited on two occasions by Revenue Canada at a time when Revenue Canada was no longer willing to apply the charitable goods policy to CMDA. CMDA's registration was revoked on the grounds of the absence of an agency or similar agreement and because its affiliate operated in the Golan Heights, the West Bank, East Jerusalem and the Gaza Strip (the Occupied Territories) in violation of a supposed Canadian public policy.

In the course of audit followup, Revenue Canada had obtained a list of all sites where Canadian supplied ambulances were used at the time – the list included one ambulance which had been transferred by the Israeli affiliate to the Israeli Defence Force as well as some ambulances used in the Occupied Territories.

CMDA appealed its revocation to the Federal Court of Appeal. The Court made short work of the public policy argument because the Crown was unable to show any consistent Canadian public policy in the area. The (three judge) Court split on the issue of whether the gifting of resources to MDA (the only remaining ground for revocation) was enough to support the CCRA's revocation of registration. The majority observed that even if the charitable goods policy was good law (and they were prepared so to assume), the transfer of medical equipment to MDA did not fall within the policy because CMDA could not reasonably have expected MDA to use the goods transferred to it only for charitable purposes (because of the ambulance transferred to the Israeli Defence Force).

The finding of the Court of Appeal in the CMDA case on public policy has provided general comfort to Jewish charities. Although leave to appeal was sought by the charity from the Supreme Court of Canada, the leave application has been abandoned as a result of the CMDA's obtaining a negotiated settlement which results in its continued charitable registration.

In the broader context, the CMDA decision is instructive on several fronts. CMDA is a very high profile charity. If the CCRA was willing to revoke its registration, no registered charity should view itself as above the law or beyond the CCRA's reach. The case (like the Tel Aviv case) also confirms the importance of dealing with issues raised in previous audits.

Terrorism

In the Spring of 2001, the federal government introduced *Bill C-16,* the *Charities Registration (Security Information) Act* (the *Security Act)* in response to media reports that Canadian registered charities were being used to fundraise for foreign terrorist organizations. This *Bill C-16* gave the government the power to revoke the registration of a registered charity which was involved in fundraising for terrorist organizations. There were significant difficulties identified by charities and their representatives and it appeared that *Bill C-16* would either be scrapped or substantially redesigned. *Bill C-16* targetted charities only, suggesting that the problem was charities' fundraising for terrorism, not that terrorist fundraising was occurring. As well, *Bill C-16* contained no definition of terrorism.

September 11, 2001 changed the political landscape significantly. In short order, *Bill C-36* was introduced which revived the *Security Act.* However, unlike *Bill C-16, Bill C-36* addressed terrorist fundraising by charities as part of a much broader context. The definitions of terrorism contained in various U.N. Conventions were imported into *Bill C-36.* More importantly, *Bill C-36* criminalized terrorist fundraising, whether carried on through a registered charity, through any other organization, or by an individual.

Thus, *Bill C-36* downplayed the implications that terrorist fundraising was a charity problem and that charities are more likely to fund terrorists than are other types of organization. These conceptual level changes in approach, especially in the post September 11, 2001 context, were enough to satisfy many critics of *Bill C-16* and *Bill C-36* was passed into law.

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Only judge can revoke a security certificate

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The *Security Act* provides:

The Minister and the Minister of National Revenue may sign a certificate stating that it is their opinion, based on security or criminal intelligence reports, that there are reasonable grounds to believe:

(a) that an applicant or registered charity has made, makes or will make available any resources, directly or indirectly, to an entity that is a listed entity as defined in *subsection 83.01(1)* of the *Criminal Code;*

(b) that an applicant or registered charity made available any resources, directly or indirectly, to an entity as defined in *subsection 83.01(1)* of the *Criminal Code* and the entity was at that time, and continues to be, engaged in terrorist activities in support of them; or

(c) that an applicant or registered charity makes or will make available any resources, directly or indirectly, to an entity as defined in *subsection 83.01(1)* of the *Criminal Code* and the entity engages or will engage in terrorist activities as defined in that subsection or activities in support of them.

Upon the issuance of a certificate for the reasons described above, the Solicitor General (Canada's chief law enforcement officer, who is the "Minister" referred to in the *Security Act)* must bring the certificate before a judge for review.

The *Security Act* provides for a secret hearing of the evidence against the charity without even the charity or its counsel being permitted to be present, if the judge determines that disclosure to the charity or its counsel would injure national security or endanger the safety of any person.

After the hearing, the judge can revoke or deny charitable registration. The decision of the judge in the matter is final and not subject to appeal. However, it is possible for an organization which has been refused charitable registration or which has had its registration revoked on the ground that it funds terrorism, to reapply to the CCRA for registration on the ground that the reasons for the issuance of the original certificate are no longer valid.

Not consistent with common law

It is obvious that the procedure described above is not consistent with the common law traditions of full disclosure and open justice. The CCRA has indicated that in the post-September 11, 2001 context, the procedural approach described in the *Security Act* is not a violation of fundamental freedoms to which the *Charter of Rights* would apply. Since court challenges are already under way, time will tell.

Leaving aside procedure, one serious concern which remains is that the *Security Act* provides for the denial or revocation of registration for an organization which makes funds indirectly available to a terrorist organization. Since there is no explicit knowledge requirement in this portion of the *Security Act,* an organization such as a relief organization which provided food or medical aid in a war zone could potentially be found to have made resources available indirectly to a terrorist organization. The portion of the *Security Act* which criminalizes fundraising for terrorism provides that allowing resources to be used for terrorism is only a criminal offence if done "willfully and without lawful justification or excuse".

Provides defence in law

This modifier would provide a criminal law defence for an organization which inadvertently permitted its resources to be used for the benefit of a terrorist organization. There is no such explicit qualifier in the charities registration portion of the *Security Act,* although it is to be hoped that judges applying the *Security Act* would imply one.

Charities and their advisors have taken a number of approaches to the *Security Act.* Some advisors have suggested that pre-existing law deals adequately with the issue so the *Security Act* should be scrapped.

A number of other advisors as well as some umbrella organizations have suggested that the current anti-terrorism provisions are an appropriate response in a post September 11 world and that, at least in the short term, it is appropriate to rely on the assurances of the CCRA that it intends to interpret the anti-terrorism provisions in a sensible manner.

My view leans toward the second of these two approaches. Since the *Security Act* laws as drafted certainly could be misused by the CCRA, their application should be carefully monitored.

On a cautious approach, many charities should be concerned about the implications of the *Security Act.* Charities which work overseas (particularly those which do relief and development work) need to be cautious. Some activities (particularly those carried out through foreign agents) should only be carried out after careful due diligence or even after obtaining specific pre-clearance from the CCRA.

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