Canada Revenue Agency | Agence du revenu du Canada

REGISTERED MAIL

Biathlon Canada
C/O Daniel F. O'Connor
755 St-Jean Boulevard, Suite 401
Pointe-Claire QC H9R 5M9

BN: 132574104

Attention: Mr. Daniel O'Connor

File #:0496281

November 1, 2010

Subject: **Revocation of Registration**
Biathlon Canada

Dear Mr. O'Connor:

The purpose of this letter is to inform you that a notice revoking the registration of Biathlon Canada (the Association) was published in the *Canada Gazette* on October 30, 2010. Effective on that date, the Association ceased to be a registered Canadian amateur athletic association (RCAAA).

Consequences of Revocation:

a) The Association is no longer exempt from Part I Tax as an RCAAA and **is no longer permitted to issue official donation receipts.** This means that gifts made to the Association are no longer allowable as tax credits to individual donors or as allowable deductions to corporate donors under subsection 118.1(3), or paragraph 110.1(1)(a), of the *Income Tax Act* (the Act), respectively.

b) The *Excise Tax Act* (ETA) defines a "charity" in subsection 123(1) as "a registered charity or registered Canadian amateur athletic association within the meaning assigned to those expressions by subsection 248(1) of the Act, but does not include a public institution". Therefore, under the ETA an RCAAA is referred to as a "charity". The Association will no longer qualify as a charity for purposes of subsection 123(1) of the ETA, effective the date of revocation. As a result, it may be subject to obligations and entitlements under the ETA that apply to organizations other than charities. If you have any questions about your GST/HST obligations and entitlements, please call

GST/HST Rulings at 1-888-830-7747 (Quebec) or 1-800-959-8287 (rest of Canada).

In accordance with *Income Tax Regulation* 5800, the Association is required to retain its books and records, including duplicate official donation receipts, for a minimum of two years after the Association's effective date of revocation.

Finally, we wish to advise that subsection 150(1) of the Act requires that every corporation (other than a corporation that was a registered charity throughout the year) file a *Return of Income* with the Minister of National Revenue (the Minister) in prescribed form, containing prescribed information, for each taxation year. The *Return of Income* must be filed without notice or demand.

If you have any questions or require further information or clarification, please do not hesitate to contact the undersigned at the numbers indicated below.

Yours sincerely,

Danie Huppé-Cranford
Director
Compliance Division
Charities Directorate
Telephone: 613-957-8682
Toll free: 1-800-267-2384

Enclosures
- Canada Gazette publication

Cc: Mr. Graham Lindsay, President
2197 Riverside Drive, Suite 111
Ottawa ON K1H 7X3

Canada Revenue Agency | Agence du revenu du Canada

REGISTERED MAIL

AUG 18 2010

Biathlon Canada
c/o Daniel F. O'Connor
755 St-Jean Boulevard, Suite 401
Pointe-Claire QC H9R 5M9

BN: 132574104RR0001
File #: 0496281

Attention: Mr. Daniel O'Connor

Subject: Notice of Intention to Revoke
Biathlon Canada

Dear Mr. O'Connor:

I am writing further to our letter dated August 29, 2009 (copy enclosed), in which you were invited to submit representations as to why the registration of Biathlon Canada (the Organization) should not be revoked in accordance with subsection 168(1) of the *Income Tax Act*.

We have now reviewed and considered your written responses dated October 29, 2009 and May 11, 2010. However, notwithstanding your replies, our concerns with respect to the Organization's non-compliance with the requirements of the Act for registration as a registered Canadian amateur athletic association have not been alleviated. Our position is fully described in Appendix "A" attached.

Consequently, for each of the reasons mentioned in our letter dated August 29, 2009, I wish to advise you that, pursuant to the authority granted to the Minister in subsection 168(1) of the Act, which has been delegated to me, I propose to revoke the registration of the Organization. By virtue of subsection 168(2) of the Act, revocation will be effective on the date of publication of the following notice in the *Canada Gazette*:

> *For issuing more than $25.9 million in donation receipts for abusive transactions arising from its role as a participant in tax shelter arrangements that, in the opinion of the Canada Revenue Agency, do not qualify as gifts, notice is hereby given, pursuant to paragraph 168(1)(d) of the* Income Tax Act, *that I propose to revoke the registration of the organization listed below. In accordance with subsection* 168(2) *of the* Income Tax Act, *the revocation of registration is effective on the date of publication of this notice.*

Canada

Place de Ville, Tower A
320 Queen Street, 13th Floor
Ottawa ON K1A 0L5

Business Number	Name
132574104RR0001	Biathlon Canada Ottawa ON

This notice will be published in the *Canada Gazette* upon the expiration of 30 days from the mailing of this letter.

Consequences of Revocation

As of the effective date of revocation, the Organization **will no longer be permitted to issue official donation receipts.** This means that gifts made to the Organization would not be allowable as tax credits to individual donors or as allowable deductions to corporate donors under subsection 118.1(3), or paragraph 110.1(1)(a), of the Act, respectively.

I trust the foregoing fully explains our position.

Yours sincerely,

Cathy Hawara
A/Director General
Charities Directorate

Attachments:
- CRA letter dated August 29, 2009 and April 12, 2010;
- Your letter dated October 23, 2009, October 29, 2009 and May 11, 2010; and
- Appendix "A", Comments on representations

c.c.: Mr. Graham Lindsay, President
2197 Riverside Drive, Suite 111
Ottawa ON K1H 7X3

CANADA REVENUE AGENCY | AGENCE DU REVENU DU CANADA

REGISTERED MAIL

Biathlon Canada
2197 Riverside Drive, Suite 111
Ottawa ON K1H 7X3

BN: 132574104 RR0001
File #: 0496281

Attention: Mr. Ray Kokkonen, president

August 29, 2009

Subject: Audit of Biathlon Canada

Dear Mr. Kokkonen:

This letter is further to the audit of the books and records of the Biathlon Canada (the Organization) by the Canada Revenue Agency (the CRA). The audit related to the operations of the registered Canadian amateur athletic association (RCAAA) for the period from April 1, 2004 to March 31, 2007.

The CRA has identified specific areas of non-compliance with the provisions of the *Income Tax Act* (the Act) or its *Regulations* in the following areas:

AREAS OF NON-COMPLIANCE:		
	Issue	**Reference**
1.	Issuing official donation receipts other than in accordance with the Income Tax Act or its regulations	168(1)(d)
2.	Failure to file an information return as and when required by the Act and/or its Regulations	Reg. 200(1) & (2) 153(1)(g)

The purpose of this letter is to describe the areas of non-compliance identified by the CRA during the course of our audit as they relate to the legislative provisions applicable to RCAAAs and to provide the Organization with the opportunity to make additional representations or present additional information. In order for a registered RCAAA to retain its registration, legislative and common law compliance is mandatory, absent which the Minister of National Revenue (the Minister) may revoke the Organization's registration in the manner described in section 168 of the Act.

The balance of this letter describes the findings of the audit in further detail.

Summary: Participation in Various Tax Shelter Gifting Arrangements

The audit revealed that, during the periods under review, the Organization participated in the following tax shelters:

- Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities (TS69260) – 2004 and 2005
- Donations for Canada (TS70623) – 2005, 2006, and 2007

While participation in tax shelter gifting arrangements is not prohibited by the Act *per se*, the CRA is extremely concerned that the Organization may be facilitating abusive arrangements with little regard to its own operations and legislative provisions applicable to RCAAAs. The Organization agreed to issue tax receipts on behalf of the arrangements for "property" the Organization flowed through its bank accounts of which it is entitled to immediately keep 1% of and failed to demonstrate its due diligence prior to entering into the agreements or its on-going review of the donation arrangements. Each of the donation arrangement programs were created by persons other than the Organization and the Organization merely accepted the terms of participating in order to receive its compensation.

Our audit revealed the Organization issued receipts totaling $25,974,509[1] while its issuance of receipts have increased from approximately $610 in 2002 to $5 million in 2003[2], $5 million in 2004 ($1.1 million from Donations Canada program, $3.9 million from the Athletic Trust 2002 program), actually immediately receiving $259,745. The remainder of the funds was transferred by the Organization to off-shore "investments" purportedly held on behalf of the Organization and to pay fundraising fees to the promoters of the donation arrangements. As described below, our audit has revealed that these investments do not exist and that the funds are immediately repaid to the original lenders. Accordingly, it is our view that, through its participation in each of these programs, the Organization has issued receipts otherwise than in accordance with the Act and its Regulations.

Overview - Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities (TS69260) – 2004 and 2005 – promoted by ParkLane

To illustrate our audit findings and positions, we will use Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities - 2004 Series A throughout our letter. Despite minor differences in details, the principal concepts in our illustrations are applicable to each of the tax shelter donation arrangements in which the Organization participated[3]. A more detailed analysis of the step-by-step transactions involved in the Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities - 2004 Series is outlined in Appendix "A".

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[1] $5,420,326 in 2004, $15,551,783 in 2005 and $5,002,400 in 2006

[2] Primarily due to the Organization's participation in the 2002 Athletic Trust donation arrangement

[3] The 2005 Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities differed from the other tax shelters arrangements in that the participants "donated" sub trust units received freely distributed by a trust plus cash instead of loaned funds to the Organization. The Organization purportedly converts the sub trust units to cash and agrees to transfer 99% of all cash off shore.

Using a hypothetical $10,000 "donation" as an example, a participant in this tax shelter arrangement would only be required to personally contribute $2,790. The participant would subsequently "borrow" $11,200 from a pre-arranged lender - Plaza Capital Finance Corp. (the Lender). These amounts, $13,990, are held by an escrow agent in trust on the participants' behalf prior to orders from the Organization for disbursement[4].

The loans secured by participants bear interest at the rate of 3% and have a ten-year term. Interest must be paid within 60 days of December 31st, each year. The participant directs the escrow agent to pay $336 to the Lender in payment of the first year's interest on the loan.

Each participant directs the escrow agent to deposit $10,000 of the $13,990 held in trust in a [redacted] account in the Organization's name. For a $10,000 donation, the Organization would be required to direct the [redacted] to transfer $9,900 to Trafalgar Trading Limited (TTL) pursuant to a Royalty Agreement, which entitled the Organization to receive from 60% to 80% of any monthly profits earned based on the year and type of Royalty Agreement. Approximately $600[5] of the $9,900 transferred to TTL is transferred to ParkLane Financial Group for promotional expenses. Each of these transactions would occur within a 24-hour period.

The participant also directs the escrow agent to remit the remaining $3,654 to Specialty Insurance Limited (SIL) as payment on the premium for a Policy of Insurance. Pursuant to this policy, SIL agrees to pay to the participant an amount equal to the difference between the expected annual rate of growth, 6.054%, and the actual rate of growth under the investment contract agreement between SIL and TTL. The insurance is payable only if the annual rate of growth under the investment contract is less than 6.054% per year.

It is represented that the investment contract and the insurance policy together will generate a minimum of $11,200 in 10 years (thereby paying off the loan advanced to the participants). Based on the leveraged amount a rate of return of 52.96%[6] would be required to accomplish the repayment.

In the end, for each tax-receipted $10,000 "donation", the Organization immediately receives unfettered access to and use of $100 and an unknown future "revenue-stream"; reports fundraising fees paid of $600; and "investments" of $9,300. Of the "invested" funds, the majority of the funds are transferred to corporations connected to the promoters or returned to the lender (refer to Appendix "A"). For its $10,000 "donation", the participant is out of pocket $2,790 yet has an official donation receipt for which he can claim a donation tax credit of at least $4,641[7].

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[4] The instructions provided by the Organization were also pre-arranged by the creators of the tax shelter programs and the Organization was found to accept the directions to transfer the funds off-shore, as presented by the creators of the programs

[5] The fundraising fee increased to 8% in 2007.

[6] In order for the present value of the $159.80 annuity to achieve the required $11,200 over a 10 year period, it would need to achieve an annual rate of return of 52.96%.

[7] Based on Federal and Ontario donation tax credits of 46.41%

It is important to note that per the CRA audit, the Organization has only received $43,650 (0.17%) in profit payments despite issuing $25,974,509 in receipts. The Organization has also incurred an average annual loss of 1.11% on the capital investment. Based on this rate of return, the Organization will receive a total of $293,475 for the investments over a 20-year period and the capital would erode to $18,992,473 USD for a net loss of $2,441,035 USD if the investments actually exist. Refer to our discussion below on the existence of the property.

Given the facts as known by CRA, the "net loss" is substantially more due our findings that only a maximum of $159.80 per $1,000 tax-receipted donation for each of the Series A programs (see Appendix "A") is, in fact, potentially invested. Based on these figures, the actual capital after 20 years would likely only be $1,042,850 USD for a net loss of $20,390,659 USD.

Issuing official donation receipts other than in accordance with the Income Tax Act or its Regulations

Gifts:

It is our position that the Organization has contravened the *Income Tax Act* by accepting and issuing receipts for transactions that do not qualify as gifts.

No *Animus Donandi*

Under the common law, a gift is a voluntary transfer of property without consideration. However, an additional essential element of a gift is *animus donandi* - that the donor must be motivated by an intention to give. It must be clear that the donor intends to enrich the donee, by giving away property, and to generally grow poorer as a result of making the gift.

Our position is the donations received by the Organization from participants are not true gifts under section 118.1 of the Act. In our view, it is clear that the primary motivation of the participant is to profit through the tax credits so obtained through a series of artificial transactions and a minimal monetary investment. It is our view that the Organization was aware, or ought to have been aware, that it was participating in schemes designed to produce inappropriate tax benefits through an artificial manipulation of the tax incentive.

In support of this position, we note that:

- The promotional material for each of the donation arrangements promise the participant will receive a tax credit at the highest marginal tax rate for the combined value of the gifts and provides charts calculating the participants return on cash investment of at least 67% and as high as 94%. For example, the promotional material shows that for a $315 cash contribution by a donor in Ontario, coupled with a $10,000 "loan" received by and "donated by a donor in Ontario, will result in a tax credit of $464, thereby generating a positive cash flow of $149".
- Participants in this arrangement, in return for a minimal participation fee, received a "loan" with full and prior knowledge that this loan would never have to be repaid by the borrower. Due to a combination of insurance and aggressive investment strategies,

participants are lead to believe it is highly unlikely or necessary they will have to repay the "loans".

- Transactions are pre-arranged, pre-determined and coordinated by the promoters and other pre-arranged third parties. The Organization has no interaction or involvement with participants seemingly whatsoever nor are the participants prior or subsequent supporters of the Organization's activities outside of the tax shelter arrangements.
- Minimal information is provided to the prospective participants as to how the "donations" would benefit the Organization or to the activities of the Organization they are supporting;
- The participant receives an official donation receipt for the full amount of their purported "donation" of which they contribute out of pocket cash of 28% with the remaining 72% coming from a no-recourse loan guaranteed by an insurance policy in the 2004 Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities. The participant receives an official donation receipt for combined 25% cash contribution and the 75% trust unit value in the 2005 Donations for Canada program.
- The Organization never truly receives the funds "donated". While the funds are deposited temporarily in the Organization's bank account established solely to receive and distribute funds received these funds, as a part of its participation in the arrangements, the Organization is obligated to immediately transfer 99% of the funds deposited to a company directly connected to the promoter.
- The transactions are carefully arranged, as described in Appendix "A" to create the illusion of property being donated to the Organization and invested. In actual fact, these funds followed a circular flow and ended up back in the hands of the lender (minus applicable fees to participants). The Organization initially received a 1% fee for *its* participation.
- The Organization also received a minimal "investment stream", for its participation in the arrangements.

It is clear that the primary purpose and result of these transactions was to provide the participant a donation tax credit that exceeded the participant's cost of participation. In essence, the arrangement is one whereby the promoters, the Organization and the individual participants created the illusion of property, but in reality this involved "purchasing" receipts for a fraction of the receipt's face value (i.e., that the only property involved in the scheme was the participation fee).

As above, the participants "donated" to the Organization with the clear intent to take advantage of the tax system through an artificial series of transactions. The Organization was aware, or ought to have been aware, of the motivations of the participants as it had full access to the promotional materials and information about the schemes in which it participated. In return for a participation fee, the participants secured "loans" which they knew they would never have to repay and donated these to the Organization. The Organization, for its part, issued receipts for the full value of the funds transferred - even though it was obligated to immediately transfer 99% of these funds to an offshore company. In our view, the primary motivation of the participant in these transactions was to profit from the tax system by a combination of the tax credits available for donations and the artificial loan transaction. The Organization also participated in more than one donation arrangement, whereby the transactions and results were similar, yet continually chose to participate in arrangements

when the Organization was not benefiting or receiving the profit distributions in the amounts promoted.

In our view these transactions are not true gifts in the sense contemplated by section 118.1 of the Act. In this regard, these transactions lack the requisite *animus donandi* to be considered gifts. These transactions were, in our opinion, primarily motivated by the participant's intent to enrich him/herself rather than an intent to make a gift to the Organization. As such, it is our position the Organization was not entitled to issue receipts for the property transferred to it.

It is our view that the Organization has issued receipts for a gift otherwise than in accordance with this Act subsection 118.1. For this reason, it appears to us that there are grounds for revocation of the charitable status of Biathlon Canada under paragraph 168(1)(d) of the Act.

Property donated

Existence of the property:

It is our view that the property represented as being donated is not *actually* property that has been donated to the Organization.

As above, and as detailed in Appendix "A", the Donation Program Supporting Canadian Amateur Athletics, Foundations and Charities donation arrangement involved participants themselves contributing a mere 28% of the property purportedly donated to the Organization with the remainder consisting of a loan which is highly unlikely to be repaid by the participant. The Organization receives funds in a segregate bank account to which it has no access but is obligated to transfer 99% of these to an offshore entity; 93% of which is reportedly "invested" and 6% as referral fees.

In fact, it appears these funds are not actually held as investments on behalf of the Organization but the majority of these funds were, in fact, immediately returned to the original lender or paid out as fees to the participant promoters and companies. For the 2005 and 2006 years, our audit has concluded that of the funds (99%) transferred, the majority of the funds (79.05%) were transferred back to the same lenders granting "sub-trust units" participants as software licensing fees. Of the remaining funds, a full 6% was paid to ParkLane Financial Group for fundraising fees. This, of course, would provide a mere 13.95% remaining for "investing". The Organization receives distributions from its Royalty Agreements, but it appears that this would be from the same remaining cash contributions and not from the purported full value of investments held.

As such, it is our view that the Organization has issued receipts for property that was not donated to it but that exists as little more than notations on paper as investments "owned" by the Organization. The Organization participated in schemes that, through a circular series of transactions, was designed to create the illusion of property being donated to the Organization while in actuality, the majority of the funds were either consumed by fees to be paid to the participants or returned to the lender.[8]

[8] See Appendix A – paragraphs 24-26 for detailed description

The Organization's part in these schemes were, as before, to receive funds from participants, issue tax receipts for the full amount of the property transferred flowed through its bank account, and to immediately transfer these amounts to a bank account off-shore. The Organization had no control over the property "donated" other than the 1% it retained and had no access to the investments. The Organization has not demonstrated it had control over or access to the remaining 99% of the funds allegedly donated to it or invested on its behalf. The Organization could not even verify, for the purposes of its own internal audit, the values associated with the offshore investment as indicated in the financial statements. Its auditors do not account for any assets on the balance sheet for the off-shore accounts. Rather than reasonably seek out prudent investments with the property donated to it, the Organization was obligated to send money to an offshore investment with uncertain and low rates of return.[9]

In our view the Organization participated in schemes designed to create the illusion of property being donated and issued receipts for property, which was not beneficially transferred to it. The Organization was either aware, or ought to have been aware, of the fact that its role in the arrangement whereby it issued receipts for property which would flow through its accounts but to which it had no present or even future ownership of. The funds that are represented as donated, owned and invested by the Organization were, in fact, circuitously returned to the lender. As such the Organization was not entitled to issue a receipt for the amounts contributed (in this case with reference to the insurance policy and loan or the trust units) and in this regard it is our view that the Organization has issued a receipt for a gift otherwise than in accordance with this Act which is cause for revocation by virtue of paragraph 168(1)(d).

Nature of the Property:

As above, it is our view that the Organization improperly issued receipts for transactions that were not gifts and for property that it was not, in fact, beneficially entitled to. We are of the view that the offshore investments that the Organization purports to have exist largely only notionally on paper. A fact seemingly confirmed by the Organization's own external auditors. However, even were we to agree that the gifts were valid gifts to the Organization, and the property held in investments existed, it would still be our view that the Organization issued receipts other than in accordance with the Act.

As above, the property that was donated to the Organization was immediately transferred to an offshore investment company. Based on our review, there is no indication that the principal amount of this property will ever revert to the Organization. There is no mention in the royalty agreement that the Organization will ever be entitled to the principal amount of the investment. With regards to early redemption, the agreement stipulates the following: "If the

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[9] By way of comparison, GIC average rates from 2004 to 2007 as per http://www.bankofcanada.ca were 1 yr: 2.39%, 3yr: 2.74% and 5yr: 3.05% which would have produced a revenue of $1,950,770 at the 1 yr avg. rate or $579,569 more than current investment of $43,650. Also, it is interesting to note that the royalty agreements define "contracts" as the S & P 500 and other international stock index futures yet see for example www.streetauthority.com/ma-sample.asp indicates the 5 year average rate of return on the S&P 500 is 11.26% while the royalty agreement has averaged 0.20%.

Association provides Trafalgar with a Profit Distribution Notice, during the Trading Term, Trafalgar shall be paid: 1) a fee equal to one fifth of one percent (1/5%) of the Current Trading Facility determined as at the end of the calendar month in which Trafalgar receives from the Association the Profit Distribution Notice, multiplied by twenty-four months; and 2) the aggregate of all unpaid portions of the Monthly Trading Fee forfeited by Trafalgar pursuant to section 4.2 hereof and such fees shall be subtracted from the Profit Distribution due to the Association". Profit Distribution is defined in the Agreement as being the "amount equal to the Current Trading Facility, as at the end of the calendar month in which Trafalgar Trading receives from the Association a Profit Distribution Notice, net of the Initial Trading Facility". The audit evidence revealed that the Initial Trading Facility is consistently greater than the Current Trading Facility at the end of any given month. Therefore, the application of the formula to arrive at a profit distribution, even without taking into consideration the termination fees mentioned above, will always result in a negative amount. It is clear that although the agreement allows the Organization to request a profit distribution, the termination fees as well as the formula used to calculate the "profit" would result in no funds remaining, making it impossible for the Organization to receive any payments should it exercise its option to submit a Profit Distribution Notice to Trafalgar trading Limited. As such, it appears that the Organization is only entitled to a potential "income stream" associated with the property.

In our view, even if we were to accept that the property was validly donated to the Organization (which we do not) it is the income interest in the property, which should have been tax receipted and not the full value of the funds transferred to the Organization. While the Organization does receive certain funds from participants, other than the immediate 1% to which it is entitled, it is *required* to transfer these funds to the offshore investment company. The Organization is never entitled to the property itself but to the income from the property – if there is any. In our view, while it is being represented that the full value of the property is being donated, it is simply a limited income interest in the property that is being donated.

We acknowledge that the restriction on access to the property is a condition of the Organization's participation in the donation arrangements, and not one *explicitly* set by the participant. However, viewing the "donation" as a pre-arranged transaction, the restrictions so imposed make it clear that it is the income stream, which is donated and to which the Organization is entitled, not the full value of the property. Participants pay a fee to participate in the donation programs. The participants have no interaction with the Organization. Participants obtain a loan from a non-arm's length company knowing fully that, provided they follow the instructions, they will not have to repay the "loan". One of the instructions is that they transfer these funds to a participating organization. The participating organization is obligated through the agreement to transfer 99% of these funds to the offshore investment company. The participating organization is thereafter entitled to income from the investments (when there is any) but not the principal amount.

In our view, if the Organization was receiving a donation of an "income stream" from the property, a professional valuator should have valued this income stream and the tax receipts issued accordingly. In this regard, even if the Organization had issued a receipt for the valuation amount, it would not have been in accordance with proposed subsections 248(31), (32) and (34) regarding limited recourse debts.

It is our view that the Organization has issued a receipt for a gift otherwise than in accordance with Act subsection 110.1 and 118.1, which is cause for revocation by virtue of paragraph 168(1)(d).

Application of proposed subsections 248(31), (32) and (34) regarding limited recourse debts

As above, even if we were of the opinion that the payments made by participants to the Organization constituted "gifts", which, in our view is not the case. In 2003, the Department of Finance introduced new legislation with respect to charitable donations and advantages. These rules allow a taxpayer to make a gift to a RCAAA and receive some advantage in return; however the value on the receipt must reflect the eligible amount of the gift made (i.e., the value of the receipt must reflect the gift less any advantage received by the donor). We would note that, although still proposed, once passed into law, these subsections apply retroactively to the fiscal periods currently under review.[10]

It is our view that the participants received an advantage, as defined at proposed subsection 248(32), as a result of the cash contribution to the Organization, in the form of receiving a limited-recourse, low-interest debt. A limited-recourse debt is broadly defined to include any unpaid amounts if there is a guarantee, security, or similar indemnity or covenant in respect of the debt. The value of this advantage should have been deducted from the eligible amount of the gift. As the purported value of the loans exceeded the participant's cash outlay, under the proposed legislation, the Organization was not entitled to issue receipts for these "donations". Further, even if the loans were found not to be consideration for participant's cash contributions, the proposed legislation has broad applications and also includes advantages that are "in any other way related to the gift".[11] As such, it is our view that the Organization, under the proposed legislation should not have issued tax receipts for the participant's out-of-pocket cash outlay. In our view, the Organization was aware of this loan, having been provided the promotional materials relating to the programs, and accordingly was obligated to reduce the eligible amount of each gift recorded on the tax receipt.

Under proposed subsection 248(34), the taxpayer, if we were to accept that a gift had been made to the Organization, may have been eligible for a tax receipt for payments towards the principal of the loan, but was not entitled to a tax receipt for the *entire* amount purportedly donated.[12] This subsection generally provides that the gift portion of any transaction involving a limited recourse debt is deemed to be no more than the amount of the initial cash payment. A taxpayer may, additionally, claim a gift with respect to a repayment of the principal amount of the limited-recourse debt in the year it is paid. There was no indication during our review that the Organization took these provisions into account when issuing receipts on behalf of the tax shelter arrangements.

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[10] Subsections 248(31) apply in respect of gifts made on or after December 20, 2002 and 248(32), and (34) apply in respect of gifts made on or after February 19, 2003.

[11] Ss. 248(32)

[12] Again, given the fact that the majority of out-of-pocket funds were paid out to participants and the "loans" were immediately repaid to the lender, it is our view that these transactions were not true gifts to the Organization.

As such the Organization was not entitled to issue a receipt associated with the limited recourse debt (in this case with reference to the promissory note) and in this regard it is our view that the Organization has issued a receipt for a gift otherwise than in accordance with this Act, which is cause for revocation by virtue of paragraph 168(1)(d).

Seriousness of the Offence:

As above, the CRA is greatly concerned about the participation of the Organization in these arrangements. It is the CRA's view that these gifting arrangements provide minimal benefit for the programs of the Organization as compared to the values of tax receipts being issued. The *Income Tax Act* provides RCAAAs the privilege of issuing tax receipts to allow them to solicit donations from taxpayers for use in their programs. However, in the case at hand it appears that the Organization participated in tax shelter arrangements by lending its tax receipting privileges in return for a small percentage of the face value of the receipts so issued. It is interesting to note that since its participation in these programs, its issuance of receipts have increased from approximately $610 in 2002 to $5 million in 2003[13], $5 million in 2004 ($1.1 million from Donations Canada program, $3.9 from the Athletic Trust 2002 program), $5.4 million in 2005, $15.5 million in 2006, and $5 million in 2007. We would note, in this regard that the effects of the Organization's participation in these programs have resulted in the Organization issuing receipts for $25,974,508[14] yet actually receiving only $303,396 from these donation arrangements. In our view, this represents a serious abuse of the Organization's receipting privileges.

As a result of the Organization's participation in these tax shelter programs, the following occurred:

- Gross fundraising fees (6.39% of receipted amounts) paid to the promoters $1,658,519;
- Gross fees paid to Trafalgar Trading Limited, which consist of monthly trading fees plus 20% of monthly profits, of $102,329 USD ($120,665 CAN)[15]; and
- Gross investment profits paid to the Organization of $43,650 US ($51,588 CAN).

At the same time, the investments have depleted in value by $295,830 USD ($1,147,861 CAN[16]). These findings further point to the fact that the amounts expensed on fundraising and other costs associated with the program substantially outweigh the amounts which were made available for use by the Organization in its charitable activities.

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[13] Primarily due to the Organization's participation in the 2002 Athletic Trust donation arrangement

[14] Furthermore according to the organizations own financial statement an addition $3,458,750 of receipts were issued for the program in 2008 for a total of $29,433,258.

[15] The CAN conversion is based on the December 30 Bank of Canada (BAC) noon rates which were 1.2036 in 2004, 1.1659 in 2005 and 1.1653 in 2006.

[16] Due to a large discrepancy in the exchange rate in 2004, the CAN$ loss is substantial vs. the USD per the statements. The Organization recorded transferring $1,717,000 CAN on July 28th; however, the investment statement for October indicates $2,145,432.25 USD (exchange rate equals 1.2491 vs. BAC rate of .7516). A further $3,648,473 was transferred on October 28, 2004 and recorded at $2,885,146 USD (exchange rate equals .7908 vs. BAC rate of .8199).

Furthermore, issuing donation receipts for amounts that are not gifts or that contain inaccurate values or false information, is a serious offence. In light of the volume of the receipts so issued by the Organization we are of the view that this is cause for the revocation of its registered status. As above, this situation is compounded by the fact that based on our review, the majority of funds represented as "investments" exist only notionally on paper and the Organization has not sufficiently demonstrated otherwise.

Due Diligence:

We note with concern, with respect to this particular issue, that it fully appears that the Organization's directors have demonstrated a complete lack of due diligence with respect to receipting practices. While this is not a ground for revocation itself, it is our view that it is a contributing factor to the aforementioned non-compliance and is relevant to our decision on the appropriate measures CRA should take to address these compliance issues.

In our view, the Organization was aware that there was considerable uncertainty as to their "investments" in the off-shore accounts but failed to take appropriate measures to safeguard its assets. This includes, but is not limited to not choosing a proper investment strategy consisting of standard investments, failure to take measures to ensure the integrity of the principal portion of the investment, and failure to take steps to verify the legitimacy of the transactions which are reported to the CRA. In this regard we would highlight the following:

- The Organization has indicated that is has received independent legal opinion of the donation program; however, it has refused to provide the opinion to CRA under solicitor/client privilege. The CRA is therefore unable to confirm that the opinion supports the Organization's decision to be involved;
- The Organization states that it became involved because "There was a very good opportunity to bring in large donations to our sport and to have future revenues over a longer period of time"; however, it is clear from the Organization's response that it understood it would forgo 99% of the donations for investments in a portfolio that gave no guarantee of rate of return and was invested in high risk futures contracts;
- Furthermore, it is clear that the Organization was satisfied with the 1% accommodation fee given the annual rate of return below 1% when it agreed to participate in five Royalty Agreements;
- It is the opinion of the CRA based on the language of Section 3 – Trading of the Royalty Agreements that all trading is at the discretion of TTL and that the Organization has relinquished all rights and direction of the "investment portfolio";
- According to Section 7.2 of the Royalty Agreements, TTL on an annual basis, was to engage auditors (at their expense) to verify the monthly returns submitted to the Organization. It is CRA's understanding that no such audit report has ever been received by the Organization, nor has the Organization's Board of Directors requested it in order to perform yearly due diligence on "its" investments;
- The Organization has indicated to the CRA that "it is our understanding that the invested funds are the property of Biathlon Canada" yet a review of the Organization's Financial Statements clearly show that the "investment" does not appear as an asset and therefore the CRA must conclude that the Organization does not believe it has ownership in these "investments" and simply was a conduit for receipting purposes.

The CRA's position that the Organization did not perform proper due diligence is further demonstrated in reviewing the Organization's financial statements. Therein we note that the Organization with respect to its own mutual fund investments, takes a very cautious and prudent investment approach to reduce its portfolio risk.

It is our view that the Organization failed to demonstrate due diligence in verifying the authenticity of the donation program, as well as how participation in the program furthers the objects of the organization. It appears that, as above, the Organization has willingly participated in abusive tax shelter arrangements, in effect, by being paid a small percentage fee for transactions it knew our ought to have known were not gifts it. As above, our audit has determined that the receipts issued by the Organization are not compliant with the Act including the proposed legislation that was introduced in 2003. Our audit has further revealed that the funds purportedly sent by the Organization to be invested off-shore were returned to the lender. In our view, the Organization has facilitated these arrangements without concern for the legitimacy of the program or the integrity of its assets as "the one percent received up front was a significant amount to our Association for the conduct of programs."

In this regard, it is our view that there are ground to revoke the Organization by virtue of paragraphs 168(1)(b) and (d) as it has issued receipts for a gift otherwise than in accordance with this Act section 110.1 and 118.1.

Other Compliance issues:

The audit revealed that the Organization provides annual payments for services for which it does not issue or file T4A Supplementaries. Regulation 200(1) of the Act states:

"Every person who makes a payment described in subsection 153(1) of the Act shall make an information return in prescribed form in respect of the payment unless an information return in respect of the payment has been made under sections 202, 214, 237 or 238."

Subsection 153(1) of the Act states:

"Every person paying at any time in a taxation year

(g) fees, commissions or other amounts for services, other than amounts described in subsection 115(2.3) or 212(5.1),

shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee's tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution."[17]

[17] In 2005, the technical interpretations department concluded that persons other than federal bodies paying fees, commissions or other amounts for services listed in paragraph 153(1)(g) of the Act would have to report

Subsection 200(2) of the Act states:

"Every person who makes a payment as or on account of, or who confers a benefit or allocates an amount that is,

(a) a scholarship, fellowship or bursary, or a prize for achievement in a field of endeavour ordinarily carried on by the recipient thereof"

The Organization entered into several personal service contracts between fiscal 2004 and 2006 whereby the contracts clearly state that the individuals are employees and the terms of remuneration for services. For example:

- In 2007, [redacted] received $4,000 for an athlete performance bonus;
- [redacted] received $12,120 in 2006 and $4,890 in 2007 for services;
- [redacted] received $9,120 in 2006 and $4,000 in 2007 for services; and
- And [redacted] received $4,475 in 2006 and $9,071 in 2007 for services.

Conclusion:

The Organization's Options:

a) No Response

You may choose not to respond. In that case, the Director General of the Charities Directorate may give notice of its intention to revoke the registration of the Organization by issuing a Notice of Intention in the manner described in subsection 168(1) of the Act.

b) Response

Should you choose to respond, please provide your written representations and any additional information regarding the findings outlined above **within 30 days** from the date of this letter. After considering the representations submitted by the Organization, the Director General of the Charities Directorate will decide on the appropriate course of action.

If you appoint a third party to represent you in this matter, please send us a written authorization naming the individual and explicitly authorizing us to discuss your file with that individual.

If you require further information, clarification, or assistance, I may be reached at (613) 957-2174 or by facsimile at (613) 946-7646.

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them on Form T4A if they were not already reported under Regulations 202, 214, 237 or 238. The above tax reporting obligation exists regardless whether those contracts payments are subject to withholding tax or not.

Yours sincerely,

Neil Nicholls
Auditor
Compliance Section
Charities Directorate

cc: Margaret Imrie, Director
Box 179
Falcon Beach MB R0E 0N0

Enclosure

CANADA REVENUE AGENCY | AGENCE DU REVENU DU CANADA

Biathlon Canada
c/o Daniel F. O'Connor
755 St-Jean Boulevard, Suite 401
Pointe-Claire QC H9R 5M9

BN: 13257 4104 RR0001
File #: 0496281

Attention: Mr. Daniel O'Connor

April 12, 2010

Dear Mr. O'Connor:

RE: Biathlon Canada

Further to our discussion of October 21, 2009, I have reviewed your letter requesting clarification from the Canada Revenue Agency (the CRA) regarding certain issues raised in our audit letter of August 29, 2009. Please find below responses and additional material which we trust will further clarify the CRA's position in this regard.

Per our previous letter, it is the position of the CRA that Biathlon Canada has facilitated an abusive arrangement by issuing official tax receipts for property purportedly donated to it which flowed in a circular fashion back to the lender. As outlined in that letter, it is our view that the receipts issued were not in accordance with the *Income Tax Act* (the Act) and are grounds for revocation of Biathlon Canada. It is our view that the RCAAA's conduct – retaining 1% of donations received and flowing the remainder through its bank accounts and transferring these funds to an off-shore account it had no control or access over – can only be viewed as designed to facilitate this scheme. Based on this conduct, it is the CRA's view that Biathlon Canada knew or was wilfully blind to the true nature of the scheme. While we note that, in the letter of October 23, 2009, Biathlon Canada represents that it has been a victim of this program, it has not represented how it might remedy the loss of almost $26 million of donated funds.

In response to the questions posed in you letter, we offer the following responses:

Q1 – In assessing the validity of the program, we understood that a taxpayer should not be denied the benefit of a tax provision simply because the transaction was motivated for tax planning purposes. Is it the position of the CRA that this assumption was erroneous?

Our Response

It is generally accepted that the charitable tax credit available with respect to a donation is not usually an advantage or benefit that would affect whether a gift is made[1]. However, the Courts have made equally clear that an essential element of a gift is the donor's *animus donandi* – that "the donor must be aware that he will not receive any compensation other than pure moral benefit; he must be willing to grow poorer for the benefit of the donee without receiving any such compensation."[2]

It is our position that mass-marketed donation arrangements promising participant donors that they will be able to claim tax credits for charitable donations far in excess of the expenditures actually made (i.e. the actual cash outlay and subsequent reduction in the donor's net worth), lack the requisite *animus donandi* for the transactions to be considered gifts. As stated by Justice Archambault of the Tax Court of Canada, "The technique in all these tax shelters is the same: you write off more than the amount you have paid or are liable to pay. In this fashion, you make a profit with the tax benefit alone, so no one cares how the money is being spent."[3] As outlined in our previous letter, the scheme in which Biathlon Canada participated promised participants a return on donations far exceeding out-of-pocket outlays, achieved through a combination of loans and insurance contracts which purportedly repay such loans. The courts have agreed that where a significant benefit flowed to the participant in return for a gift made to a charity, that no gift was actually made[4].

Q2 – How in your view, was Biathlon Canada to come to the conclusion that the program would produce "inappropriate" tax benefit, or that the program amounted to a plan to "artificially manipulate" the tax incentive?

Our Response

Since 1999 the CRA has been providing, on an almost annual basis, information warning taxpayers against participation in abusive schemes. The CRA has, in these alerts, outlined its concerns with these arrangements including, but not limited to, the fact that these could result in the loss of registered status for registered charities and registered Canadian amateur athletic associations (RCAAAs).[5] Further, the Department of Finance, in 2003, announced a series of measures designed to limit, if not eliminate, the tax incentives associated with such schemes. In our view, Biathlon Canada had a significant amount of material at its disposal to determine whether a scheme may contravene the requirements of the Act.

Biathlon Canada has not provided the CRA with any information which suggests that it independently sought legal advice to verify the legality of the scheme or independently verified that the transactions to which it was a participant. In fact, we note with concern that Biathlon Canada's letter of October 29, 2009, suggests, with respect to the CRA's indication that the monies donated to Biathlon Canada have been returned to the

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[1] The Queen v Friedberg , 92 DTC 6031 (F.C.A.)
[2] The Queen v. Burns, 88 DTC 6101 (F.C.T.D.)
[3] Patricia Norton v Her Majesty The Queen 2008 TCC 91 2008 D.T.C. 2701 (T.C.C.)
[4] F. Max E. Maréchaux v. The Queen 2009 DTC 1379 (T.C.C.)
[5] http://www.cra-arc.gc.ca/gncy/lrt/vshlt-eng.html

lender, that Biathlon Canada was "not legally bound to take whatever measures might have been required to determine if such facts existed."

The Act requires RCAAAs to issue receipts only for transactions that legally qualify as gifts, and under subsection 168(1) of the Act, the CRA can revoke the registration of a RCAAA where it has issued a gift other than in accordance with the *Act*. As described in our previous letter, it is our view that Biathlon Canada has issued receipts for transactions that do not qualify as gifts, in particular given that the transactions did not occur as represented – with the funds flowing through the account of Biathlon and subsequently transferred, as instructed, to an account to which Biathlon Canada does not have access, thereupon being returned to the lender. In our view it was incumbent on the organization to verify the scheme in its entirety, including the legitimacy of the transactions involved, as Biathlon Canada was responsible for determining whether the transactions qualified as gifts at law before issuing official donation receipts.

Q3 – In the last paragraph on page 5 of your report, you state again "the participants secured "loans" which they knew they would never have to repay". Our question is whether you have any supporting information or documentation for the more categorical statement.

Our Response

Please find attached the loan guarantee insurance agreement (Appendix A) per the Trafalgar group promotional material which clearly states that the donor settles the loan through delivery of the insurance policy. Please note we had included in our letter of August 29, 2009, an Appendix "A" which detailed the flow of funds including the funds paid for the insurance policy. This information was available for Biathlon Canada to review.

Q4 – (1) Whether you have reviewed the said "instructions", (2) whether you believe that Biathlon Canada ever had a copy of these "instructions"?

Our Response

As stated in our previous letter, the CRA has reviewed loan documents and promotional material from the Trafalgar group. As above, in our view it was incumbent on the RCAAA to seek out and review such material in order to determine whether it was legally entitled to issue receipts for the transactions involved.

Q5 – Do you have any information that supports the CRA's position that the loan is a no-recourse loan? Could you also please advise whether it is the position of the CRA that such a loan renders the donation invalid.

Our Response

As stated in our previous letter, the CRA has reviewed loan documents and promotional material from the Trafalgar group. The audit concluded that each donor purchased the insurance policy as part of their participation in the tax shelter arrangement.

As such, it is the position of the CRA that Biathlon Canada participated in a tax shelter arrangement, which was structured as a limited recourse debt as defined in proposed section 143.2(6.1) as follows:

> (6.1) Limited-recourse debt in respect of a gift or monetary contribution — The limited-recourse debt in respect of a gift or monetary contribution of a taxpayer, at the time the gift or monetary contribution is made, is the total of
>
> (a) each limited-recourse amount at that time, of the taxpayer and of all other taxpayers not dealing at arm's length with the taxpayer, that can reasonably be considered to relate to the gift or monetary contribution,
>
> (b) each limited-recourse amount at that time, determined under this section when this section is applied to each other taxpayer who deals at arm's length with and holds, directly or indirectly, an interest in the taxpayer, that can reasonably be considered to relate to the gift or monetary contribution, and
>
> (c) each amount that is the unpaid amount at that time of any other indebtedness, of any taxpayer referred to in paragraph (a) or (b), that can reasonably be considered to relate to the gift or monetary contribution if there is a guarantee, security or similar indemnity or covenant in respect of that or any other indebtedness.

To further clarify our position, we bring to your attention proposed subsection 143.2(6.1) as defined in the 2006 Department of Finance Technical notes:

> "A limited recourse debt includes the unpaid principal of any indebtedness for which recourse is limited, even if that limitation applies only in the future or contingently. It also includes any other indebtedness of the taxpayer, related to the gift or contribution, if there is a guarantee, security or similar indemnity or covenant in respect of that or any other indebtedness. For example, if a donor (or any other person mentioned below) enters into a contract of insurance whereby all or part of a debt will be paid upon the occurrence of either certain or contingent event, the debt is a limited recourse debt in respect of a gift if it is in any way related to the gift. Such indebtedness is also a limited-recourse debt if it is owned by a person dealing non-arm's length with the taxpayer or by a person who holds an interest in the taxpayer."

It is our view that the purchase of the insurance policy is a guarantee, security or similar indemnity or covenant which settled the debt (See Appendix "A") and effectively renders the loan a limited recourse loan as per proposed paragraph 143.2(6.1)(c) and as such the receipt should have been reduced to reflect this benefit.

Further, with regard to the position of Biathlon Canada in its response letter dated October 29, 2009, regarding the CRA proposing revocation of charitable status on the basis of proposed legislation, we would note that once passed into law the legislation is applicable to all gifts made after February 18, 2003.

Q6 – It was our understanding that it is legal for a donor to borrow the funds used to make a donation, as long as the minimum prescribed interest rate was applied to the loan. Is this not correct?

Our Response

As described in our previous letter, it is our view that the "loans", had these transactions occurred as represented, meet the definition of limited-recourse debt as defined in ss. 143.2(6.1) in that there is "a guarantee, security, or similar indemnity or covenant in respect of the debt." In this regard, at a minimum Biathlon Canada would have been obligated to issue the receipt in accordance with ss. 248(34).

However, given that these transactions lack the essential elements of being gifts (including the fact that funds purportedly donated were used to repay the "loans") it is our view that Biathlon Canada was not entitled to issue tax receipts for these transactions at all.

Q7 – Therefore, on what basis do you take the position that Biathlon Canada never truly received these funds?

Our Response

While we have acknowledged that the funds are deposited temporarily in Biathlon Canada's bank account, as part of its participation in the program, Biathlon Canada is required to transfer 99% to accounts held by Trafalgar Trading Ltd. These funds were subsequently returned to the lender in repayment of the "loans" made to donors. In our view, the flowing of "donations" to Biathlon Canada were simply an artificial transaction, as a part of a series of artificial transactions, designed to create the illusion of funds being donated to the RCAAA. Again, we would again refer you to the section titled usage of funds on Appendix "A" of our previous letter as well as page 6 under the heading of "Existence of the property" which states the CRA position on the matter.

Q8 – Could you please provide us with supporting documentation that leads you too this conclusion.

Our Response

See Appendix "B" – flow of funds.

Q9 – Could you please advise what led you to conclude that Biathlon Canada knew, or should have known, that the program would produce "inappropriate" tax benefits, presumably to the donors? Further, what information do you have that Biathlon Canada was in any way aware of a plan to "artificially manipulate" the tax incentives? Finally on this point, could you also please expand somewhat on what you mean by such an "artificial manipulation" of the tax incentives?

Our Response

We would refer you to our response to question 2 above.

Q10 – On what basis do you allege that the funds are not held as investments, as Biathlon Canada receives monthly statements from the Trafalgar Group indicating that millions of dollars are in an account in the name of Biathlon Canada?

Our Response

Again, we refer you to the information pertaining to our response to question 2 above.

Additionally, even were we to consider the documentation provided to support the investments as a legitimate indication of the investments held by the RCAAA, which we do not, we would note that the definition of "Initial Trading Facility" in section 1 – of the definitions of the 2005 Series A Royalty Agreement references amounts comprised of "margin" (i.e., cash and leverage) which again indicates that the values represented do not necessarily equate to the amount of funds deposited by Biathlon Canada.

Q11 – What information or documentation can you provide to us to support your statement that the majority of the funds were immediately returned to the original lender?

Our Response

We would refer you to question 8 above.

Q12 – We don't believe that Biathlon Canada had information or documents that could have led Biathlon Canada to conclude as you have. On what basis do you believe that Biathlon Canada was in possession of such information at the time the programs were entered into?

Our Response

Biathlon Canada was in possession of the Royalty Agreements that outline many of our concerns. In our view, it was incumbent on Biathlon Canada to review the transactions to which it was a participant in order to determine whether these legally qualified as gifts before issuing official donation receipts. Again, it is our view Biathlon Canada has been responsible for the issuance of tax receipts totaling approximately $26 million for what are, in our view, artificial and abusive transactions.

Q13 - If Biathlon Canada did not have this information, how do you believe Biathlon Canada could have, or should have, obtained it?

Our Response

See response to question 12.

Q14 – Does it not follow that after the 20-year term (when early redemption will no longer apply) that the said formulas and "penalties" will not apply, resulting in a return of most of the principal amount? Please provide us with your views on this.

OC Response

As above, given that the majority of funds have been returned to the lenders, we find it difficult to agree with your supposition. In other words, we do not see how, after 20 years, the principal amount of Biathlon Canada's investment will be returned to it, when no funds remain.

Further, the CRA's position with respect to these Royalty Agreements was expressed in our previous letter. Based on our review, it would appear to us that, according to the contract, the funds transferred were purportedly for a 20 year "royalty stream". As such, even if we were to accept that the investments existed in the manner represented, it would appear that Biathlon Canada has purchased, with funds purportedly donated to it, a revenue stream worth much less than the original funds so donated. If Biathlon Canada has information to the contrary, we would be pleased to review it.

We trust the preceding adequately responds to the questions posed in your letter of October 23, 2009. While we acknowledge the additional submission of October 29, 2009, we also note that it is a preliminary response pending information from the CRA and Parklane. In this regard, the CRA is providing Biathlon Canada **30 days** from the date of this letter to provide its additional response. After considering the representations submitted by Biathlon Canada, the Director General of the Charities Directorate will decide on the appropriate course of action.

If you require further information, clarification, or assistance, I may be reached at (613) 957-2174 or by facsimile at (613) 946-7646.

Thank you for your cooperation.

Sincerely,

Neil Nicholls, CMA

Neil Nicholls, CMA
Audit Advisor
Charities Directorate
Canada Revenue Agency
320 Queen St. 7th Floor
Ottawa ON K1A 0L5

Enclosure:
Appendix "A" – Trafalgar Charitable Donation Program
Appendix "B" – Flow of Funds

cc: Mr. Ray Kokkonen, president
C/O Biathlon Canada
2197 Riverside Dr., Suite 111
Ottawa ON K1H 7X3

Appendix "A"

2004 Donation Program Supporting Canadian Amateur Athletics Foundations and Charities (Donation Program) (Tax Shelter #TS069260)

Registration as a Tax Shelter

1. A T5001 Application for Tax Shelter Number was submitted to Canada Revenue Agency (CRA) in respect of the above Donation Program by the promoter on Jan. 9, 2004. A tax shelter number was assigned by CRA. The promoter was named on the application form as 1602628 Ontario Inc., of Burlington, Ontario. A corporation at the same address, ParkLane Financial Group Limited (ParkLane Financial) along with another company there, Trafalgar Associates Limited, carries out the promoter functions. The shareholder of the latter two companies as of the end of 2004 was Trafalgar Securities Limited of Bermuda. The controlling shareholder of the numbered company is the Canadian president of all three companies.

2. ParkLane Financial markets the Donation Program to financial advisors and other advisors in Canada.

Signing Documents and Procedure for Signing Up

3. A donor contributed his own funds to Aylesworth Thompson Phelan O'Brien LLP, In Trust (Aylesworth) of $279 per $1,000 of donation. Per the promotional literature this $279 per thousand was "with regard to an arrangement fee and pre-payment of loan interest".

4. A donor completed a Loan Application and Power of Attorney in favour of Plaza Capital Corporation (Plaza Capital), the lender, located in Canada. The amount of the loan was $1,120 per $1,000 donation.

5. A donor completed a "Promissory Note" in favour of Plaza Capital due in 10 years in the amount of $1,120 per $1,000 donation.

6. A donor completed a Pledge, indicating an intention to make a donation in favour of a particular registered charity or charities (the charity) pledging $1,000 per $1,000 donation. (This charity could include a registered Canadian amateur athletic association.)

7. A donor completed a Direction to Aylesworth, directing $1,000 per $1,000 donation to the RCAAA, and $365.40 per $1,000 to Specialty Insurance Limited (Specialty Insurance), and $33.60 per $1,000 to Plaza Capital.

8. A donor completed a Donor Declaration Letter. Point 5 says:
I understand that the Insurance Contract (the "Insurance") issued by an insurance company (the "Insurance Company") in respect of the Program is optional and that I could have declined coverage of Insurance by sending written notice to that effect to ParkLane Financial Group Limited. I hereby confirm and agree to an allocation of the fee payable to the Insurance Company towards the purchase of Insurance.

9. The $279.00 "with regard to an arrangement fee and pre-payment of loan interest" consisted of $33.60 for one year's prepaid interest, and $245.40 as the donors' unfinanced portion of their arrangement fee. The total arrangement fee was $365.40 per $1,000 donation.

10. The donors' $279 contribution above included $33.60 of prepaid interest at 3% which was the rate prescribed by CRA.

11. The total arrangement fee of $365.40 consists of the amount to be paid to Specialty Insurance in Bermuda for:

an insurance policy	$115.00 per $1,000 donation
an investment contract	240.00 per $1,000 donation
administrative fee	10.40 per $1,000 donation
	$365.40 per $1,000 donation

12. A donor completed a Direction to Plaza Capital, directing the loan proceeds of $1,120 per $1,000 donation to be paid to Aylesworth.

Contracts Received by Donor

13. A donor received a document entitled "Policy of Insurance" in which the donor is the "Policyholder/Insured". Specialty Insurance is the sole issuer of this Policy of Insurance and is guarantor of any and all provisions contained therein. The insurance provided is described as being for the purpose of providing the donor (the Insured) with a certain rate of growth from "The Trafalgar Global Index Futures Program" (TGIFP) agreement attached to the Policy of Insurance. The donor is to receive, as insurance, a payment at the end of 10 years, representing the difference between the expected rate of growth of 6.04% and the actual rate of growth under this agreement. The amount shown as the premium paid for this policy is $115.00 per $1,000 donation.

14. The TGIFP agreement is between Trafalgar Trading and Specialty Insurance, for the donors' benefit. Specialty Insurance is to receive, on the donors' behalf, a profit distribution from Trafalgar Trading at the end of 10 years. The cost of this TGIFP investment, provided by the donor, was $240 per $1,000 donation, being part of their arrangement fee of $365.40 per $1,000 donation. A donor directed Aylesworth to pay this $365.40 to Specialty Insurance.

Source and Uses of Funds

15. The sources of funds per $1,000 donation were:

Amount borrowed from Plaza	$1,120.00
Amount contributed by donor	279.00
Total Sources of Funds	$1,399.00

16. The donors' uses of funds per $1,000 donation were:

Payment directed to RCAAA		$1,000.00
One year of prepaid loan interest		33.60
Payment directed by donor to Specialty Insurance but re-directed to Trafalgar Trading pertaining to:		
Investment Contract with Trafalgar Trading	240.00	
Loan or other amount from Specialty Insurance	115.00	
Fee charged by Specialty Insurance	.40	355.40
Payment actually received by Specialty Insurance		10.00
Total Uses of Funds		$1,399.00

Source of Funds for the Donor Loan

17. An executive of a commercial lending corporation was approached to provide funding for this donation program. A separate financing corporation (located in Canada) was set up to assemble funds from various investors.

18. Plaza Capital Finance Corporation (Plaza Capital Finance), a sister company of Plaza Capital, and also located in Canada, borrowed these funds from the financing corporation, as documented by a Promissory Note issued by Plaza Capital Finance to that corporation. These funds were transferred directly by the financing corporation to Aylesworth.

19. A donor obtained his loan from Plaza Capital, as documented by a Promissory Note issued by the donor to Plaza Capital. This Promissory Note was assigned to Plaza Capital Finance.

Flow of Funds pertaining to Donations Claimed by the Donor

20. Per Direction from the donor, Aylesworth issued a cheque to the RCAAA, which received the full amount of the funds, which the donor pledged. The RCAAA deposited these cheques into its bank account.

21. A donation receipt was issued after year-end by the RCAAA to the donors in an amount corresponding to the amount deposited by the RCAAA.

22. Per Direction from the RCAAA to its bank, the bank made an immediate payment of 99% of the total donated funds to the bank account of Trafalgar Trading in respect of the Royalty Agreement Purchase Price and Referral Fee. From this payment, Trafalgar Trading Limited directs an amount equal to approximately 6% of the amount received by the RCAAA from its account to ParkLane Financial for a donation referral fee used to pay referrers of the donors to the program. The RCAAA retained 1% of the donation amounts received by it.

23. As seen above, the RCAAA paid 93% (99% less 6%) directed to Trafalgar Trading purportedly as the purchase price of a "2004 Series A Royalty Agreement". However, as explained in more detail at Fact 24 below, Trafalgar Trading had to use these or other funds, to repay the financing corporation $1,125.60 per $1,120 of loan amount. The RCAAA's royalty agreement with Trafalgar is to earn for the RCAAA revenue over 20 years through the use of Trafalgar Trading's use of Trading Software to trade S&P 500 and other international stock futures contracts. Trafalgar Trading issued monthly statements to the RCAAA showing the investment's performance, after deduction of the monthly trading fee. Actual cheques were issued to the RCAAA for months when there was a net profit due to you. The amounts of these cheques issued to the RCAAA in calendar 2005 totaled less than 2.5% of the amount paid to Trafalgar Trading by the RCAAA for the investment in their "2004 Series A Royalty Agreement". In calendar 2006 such cheques issued to RCAAA was less than 2.0% of this amount.

Flow of Funds pertaining to Arrangement Fees

24. Per the donors' Direction at Fact 7 above, the $365.40 per $1,000, which was paid to Aylesworth, was then to be sent to Specialty Insurance. However, Specialty Insurance issued a Direction to Aylesworth directing Aylesworth to pay Specialty Insurance only 1% of the donation amount, and to pay the balance to Trafalgar Trading. Hence Trafalgar Trading received $355.40 per $1,000 donation while Specialty Insurance received $10.00 per this $1,000.

Repayment to the Financing Corporation

25. Trafalgar Trading immediately made a payment to the financing corporation equal to the funds that the financing corporation loaned earlier in the day to Plaza Capital Finance (which were provided directly to Aylesworth). This represented a repayment of $1,120 per $1,000 of donation. In addition, a fee of 0.5% to the financing corporation was included, for a repayment of $1,125.60 for each $1,120 provided earlier in the day.

26. To pay for this $1,125.60 (per 1,000 of donation) to the financing corporation, Trafalgar Trading had funds available to it from the Donation Program from two sources. These were:

Amount provided by the charities after Trafalgar Trading paid the 6% referral fee ($990 - $60)	$930.00
Amount from Specialty Insurance being $355.40 (being $365.40 less $10 retained by Specialty)	355.40
Sources of funds available to repay the financing company	1,285.40
Less: Repayment to the financing company	1,125.60
Balance of funds from the Donation Program available for both Total investments of the donor and the RCAAA	$159.80

27. ***Sources and Uses of Funds from the Donation Program***

The only funds that were injected into the Donation Program for longer than one day were the $279 cash per $1,000 of donation. This $279 could be considered to have been used as follows:

Amount of taxpayer's own funds contributed per $1,000 of donation		$279.00
Deduct: Uses of funds per $1,000 of donation:		
(a) One year's prepaid interest on taxpayer loan of $1,120 at 3%	$33.60	
(b) Amount of donation that the RCAAA was permitted to retain	10.00	
(c) Donation referral fee paid to party who referred the taxpayer	60.00	
(d) Amount that Specialty Insurance actually received for its services	10.00	
(e) Fee paid to the finance corporation for providing loan for 1 day	5.60	$119.20
Remaining portion of their contribution available for investment		$159.80

Donor Assignment of their Promissory Note and Release from their Obligations

28. The donors were to request from Plaza Capital Finance that they assign their Promissory Note to Trafalgar Trading and that Trafalgar Trading accept assignment of their insurance policy and investment contract in return for their release from their obligation under their Promissory Note. An Assignment Agreement was signed at the time of the donors' request, and the donor would have been then issued a Release by Trafalgar Trading.

The donor Promissory Note was assigned and the donor Release form was issued some time between May 2005 and June 2006.

APPENDIX "A"

BIATHLON CANADA

COMMENTS ON REPRESENTATIONS OF OCTOBER 29, 2009 AND MAY 11, 2010

Seriousness of Non-Compliance:

Based on the Canada Revenue Agency's (CRA) audit of Biathlon Canada (the Organization), the Organization primarily operates for the purpose of furthering the registered tax shelters Donation Program Supporting Canadian Amateur Athletics and Foundations and Charities and Donations Canada, by agreeing, for a fee, to act as a receipting agent for these tax shelter programs. As described in our letters of August 29, 2009 and April 12, 2010, and reiterated in the balance of this letter, our audit has shown that the Organization is operating as a conduit for the tax shelters and is in serious breach of the requirements of registration under the *Income Tax Act*. As such, it is our position that the Organization's registration should be revoked.

Our audit revealed the Organization issued official donation receipts in excess of $25.9 million, yet retained a mere $259,745, or 1% of the total cash contributed. The audit also concluded that the remainder of the funds flowed through the Organization's accounts to offshore investment accounts, to give the illusion that they were received and invested by the Organization, but were in fact immediately used to repay the original lenders for the funds loaned to participants in the tax shelters. These facts demonstrate that the Organization has participated in, and facilitated, abusive tax shelter arrangements which, in our view, is grounds for revocation in and of itself.

Validity of the Donations as Gifts:

We have reviewed your letters of October 29, 2009, and May 11, 2010, and it remains our position the Organization issued official donation receipts for gifts otherwise than in accordance with the Act and its Regulations. A registered Canadian amateur athletic association (RCAAA) is entitled, under the Act, to issue receipts for gifts that it receives. However, before an RCAAA can issue a receipt, it is incumbent on the RCAAA to determine whether the transaction qualifies as a "gift" at law.

Your representations have failed to adequately address any of the CRA's concerns that the Organization issued receipts otherwise than in accordance with the Act and its Regulations. As such, it remains our position that the Organization issued receipts for transactions that do not qualify as gifts at law, which is, in and of itself, grounds for revocation of its registered status under paragraph 168(1)(d) of the Act.

Your letter dated October 29, 2009, states that the Organization simply issued receipts for cash donations donated to it by the participants, that the participants received no benefit from making the donations and the fact that the participants borrowed the funds is not relevant. Furthermore, the Organization claims that it had no knowledge and, more alarmingly, no legal requirement to take measures to determine whether the funds borrowed by the participants to make the purported gifts were in fact returned in a circular flow to the

lender within a 24-hour period. Following the Organization's request, the CRA had provided evidence in Appendix B of our April 12, 2010 letter that proved the circular loan payments. However, the Organization appears to have either ignored the evidence presented or chosen not to provide additional representations to address this matter as it originally indicated it would in its October 29, 2009 letter.

The audit evidence reveals that the Organization received amounts from individuals, for which official donation receipts were issued, flowed the funds through its bank accounts, transferred 99% of the funds to an account in Bermuda, and retained a mere 1% for itself. From the Bermuda account, the vast majority of the funds were returned to the lenders or a Trust with interest.

We note that this issue is not a matter of interpretation of the law, but is one of facts indicating the participation of the Organization in a scheme which is, at a minimum, abusive. As such, we remain of the opinion that the transactions do not qualify as "gifts" at law. Our concerns are elaborated in the following paragraphs.

a) No *Animus Donandi*

It remains the view of the CRA that the vast majority of the transactions involving the Organization do not qualify as gifts at law as they lack the requisite *animus donandi* – or "intent to give" – where in a donor transferring property to the Organization would impoverish himself as a result. Instead, participants in these arrangements fully intend to recoup the full amounts of their "donations" and profit from an additional 67-94% return through a series of premeditated and artificial transactions.

In your letter dated October 29, 2009, you state that the Organization "has always acted within the law in issuing official donation receipts in respect of the tax shelter programs". As stated in our previous letters, the arrangements in which the Organization participated promised participants a positive return on investments of their "donations". The participants achieved this by receiving loans that, through a series of related "investments" and the purchase of an "insurance policy", would not need to be repaid or by receiving sub-trust units of a Canadian Trust for no consideration. The Organization knew, or ought to have known, that the participants were receiving receipts valued at almost four times the amount they actually contributed out-of-pocket. It is clear that the schemes in which the Organization participated were mass-marketed as an opportunity to profit from the tax system by making a small out-of-pocket payment, receiving a non-repayable loan (or, in later years, sub-trust units) and making a donation that included the amount of the loan. The Organization issued official donation receipts for the total amounts purportedly received.

We acknowledge that the Organization's banking records show the amounts purportedly received from tax shelter participants flowed through its bank accounts. However, as our audit has revealed, the arrangements require that these funds be transferred offshore to conceal the ultimate use of these funds – which was to repay the original lenders. Despite the representations made by the promoters of the tax shelter arrangements, who were engaged by the Organization to fundraise on its behalf, it is clear that the loans were not repaid by the investment contracts and specialty insurance, but were repaid out of the purported donations made to the Organization. As such, we remain of the view that these

transactions lack the requisite *animus donandi* to be considered gifts, as the participants did not give gratuitously but knew they were to receive "loans" that they were not liable to repay.

Again we note that participants in this scheme are provided with the opportunity to profit from the making of donations and the subsequent filing of their income tax returns through a series of purportedly unrelated transactions. In a recent tax court case, Justice Archibald remarked on the subject of gifting to tax shelters:

> "The technique in all these tax shelters is the same: you write off more than the amount you have paid or are liable to pay. In this fashion, you make a profit with the tax benefit alone, so no one cares how the money is being spent."[1]

In our view, the transactions in the program in which the Organization participated lack the requisite *animus donandi* to be considered gifts. As explained above, the participants do, in fact, receive consideration. The CRA remains of the opinion that the transactions are not such that the participants give of themselves to enrich a charity, but through a series of artificial transactions and a minimal monetary investment, to enrich themselves with comparatively insignificant amounts actually being devoted to charity. In our view, the Organization was fully aware of the scheme in which it participated.

Consequently, it remains our position that the Organization issued receipts for transactions that do not qualify as gifts at law, which is a contravention of its receipting privileges and, which is, in and of itself, grounds for revocation of its registered status under paragraph 168(1)(d) of the Act.

(b) Existence of Property Donated

Our previous correspondence drew the Organization's attention to the fact that the funds, which are represented as its own investments, were repaid to the original lenders. In the reply dated October 23, 2009, the Organization requested that the CRA provide the supporting documents used to arrive at our conclusion, which were provided in our letter dated April 12, 2010. In spite of this, the Organization has submitted no further details to alleviate our concerns. Therefore, the CRA has concluded that the Organization is no longer contesting our findings.

Per our previous letters, the Organization took no steps to safeguard its property and understood it would directly receive only 1% of the total amount "donated". The Organization relinquished all control and direction over the funds "invested" with offshore entities, for a 0.17% rate of return. Despite the meagre 0.17% rate of return on these "investments" and a steadily eroding principal amount, the Organization continued to participate in this program. Given the lack of due diligence the Organization has demonstrated in safeguarding the $25.9 million in funds for which it has issued official tax receipts, it is simply not an acceptable defence for the Organization to suggest it is not complicit in the scheme by denying knowledge of the circular and abusive transactions in which it has participated.

[1] *Patricia Norton v. Her Majesty The Queen* 2008 TCC 91

In your letter of May 11, 2010, you state that "the agreement signed by [the Organization] indicated that after 20 years [the Organization] could request the return of the invested capital from the donated funds, with no early penalties. It is hard to see how the CRA can find fault with that understanding or approach." We would refer you to our letter of April 12, 2010, at response 14, which clearly expresses our view as to why we find fault with the Organization's supposition that they will receive **any** return of capital if the contract is maintained in force for 20 years as envisioned by the Organization. To reiterate, we have provided ample documentation to demonstrate that the borrowed funds were returned to the lender, reaffirming our position that the funds **do not exist**. We have reviewed the "royalty agreements" for any mention of a return of capital to the Organization to no avail and have requested that the Organization submit any information to the contrary that would sway the CRA to change its position on this matter. As previously stated, we were only able to find a paragraph that mentioned the disbursement of a percentage of profits to the Organization, if any exist after the 20 years have passed.

As such, it is our position that the Organization issued receipts for property not actually donated to it, but designed to give the illusion that property has been donated to the Organization. For this reason, it remains our position that the Organization issued receipts other than in accordance with the Act and which is, in and of itself, grounds for revocation of its registered status under paragraph 168(1)(d) of the Act.

(c) Nature of Property

Although proposed legislation was noted in our initial letter, we are not relying on it as grounds for revocation. However, we remain alarmed by the nature of the arrangements whereby the Organization was required to issue a receipt for 100% of an amount but, as part of its arrangement with the tax shelter promoters, gave up access and rights to $25.9 million of funds in return for a direct 1% of the full amount and a small percentage of the future income to be generated by the investments over a period of 20 years.

As *per* our previous letter dated August 29, 2009, in our view, even if we were to accept that the property was validly donated to the Organization (which we do not) it is the income interest in the property, which should have been tax receipted and not the full value of the funds transferred to the Organization. While the Organization does receive certain funds from participants, other than the immediate 1% to which it is entitled, it is *required* to transfer these funds to the offshore investment company. The Organization is never entitled to the property itself but to the income from the property – if there is any. In our view, while it is being represented that the full value of the property is being donated, it is simply a limited income interest in the property that is being donated.

Our audit has concluded that the funds received by the Organization were placed in offshore investments to which it had no access, which, in our view, is further evidence that the funds were never beneficially owned by the Organization during the period under audit. Further, the Organization's return on investments was a meagre 0.17% while the average loss on capital has been 1.11% annually, based on past performance as *per* the monthly trading statements from Trafalgar Trading Limited.

(d) Application of Proposed Legislation & Limited-recourse Debt

It is the position of the CRA that the Organization participated in a tax shelter arrangement, which was structured as a limited-recourse debt as defined in proposed subsection 143.2(6.1) of the Act.

For the reasons expressed in our previous letters[2], the CRA remains of the view that the amounts received by the Organization are amounts which meet the definition of a limited-recourse debt. It is clear that the debts offered to the participants were, as represented by the promoters, an unpaid amount for which there was a "guarantee, security, or similar indemnity or covenant" in respect of the indebtedness. As noted in the previous letter dated April 12, 2010, in an example of proposed subsection 248(32) of the Act, the option of a participant to satisfy or pay a loan by assigning or transferring to another person a property (including the rights under an insurance policy) that has less economic value than the amount of loan outstanding would reduce the amount of the gift.

Further, your letter dated October 29, 2009, states, "Jurisprudence, as well as the notes to the proposed subsection 248(31) of the Act, tell us that a tax credit is not considered in determining whether the participant received an advantage."

We agree that the charitable tax credit available with respect to a donation is not usually an advantage or benefit that would affect whether a gift is made[3]. However, as per our previous letter dated August 29, 2009, it is our view that the participants received an advantage, as defined at proposed subsection 248(32), as a result of the cash contribution to the Organization, in the form of receiving a limited-recourse, low-interest debt for which the debt was fulfilled by the transfer of an insurance policy. Furthermore, it is our position that mass-marketed donation arrangements promising participants that they will be able to claim tax credits for charitable donations far in excess of the expenditures actually made (i.e. the actual cash outlay and corresponding reduction in the participants' net worth), lack the requisite *animus donandi* for the transactions to be considered gifts.

The courts have agreed that an element of charitable intent or *animus donandi* must be present.[4] Therefore, we do not agree with your representations that the participants in the tax shelter, by virtue of receiving a limited-recourse loan, are poorer or worse off, given that the participants were able to satisfy the terms of the loan by transferring the rights to an insurance policy to the tax shelter promoters. Furthermore, the loans were paid-off within 24 hours from the purported donations, voiding any need for the insurance policy.[5]

You further state: "[the Organization] is, and was at the relevant times, unaware of any such provision or agreement in respect of the debt." However, as noted in the previous

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[2] In particular, we refer you to our answer Q5 in the CRA letter dated April 12, 2010 in response to your query regarding the CRA's position that the loan is a no-recourse loan. [sic]
[3] *The Queen v. Friedberg*, 92 DTC 6031 (F.C.A.) at 6032
[4] *The Queen v. Burns*, 88 DTC 6101 at page 6105
[5] See Appendix B of the CRA letter dated April 12, 2010.
[7] In fact, in response to our query letter to Mr. Kokkonen dated March 19, 2008 included in his reply dated May 29, 2008 was a document dated March 31, 2003 from Ms. Shelia Zych, vice-president of Trafalgar Associates, which detailed the program including a diagram that stated: "Donor settles Loan Through Delivery of Debt Repayment Insurance Policy". This document was also included in our letter of April 12, 2010 letter.

letters, the information was available for the Organization's review[7] in the promotional material of the tax shelter. Therefore, in our opinion, the onus was on the Organization to review such documents prior to participating in the arrangements and issuing over $25.9 million in official receipts over a 3 year period.

Further, with regard to the position of the Organization in its response letter dated October 29, 2009, pertaining to the CRA proposing revocation of charitable status on the basis of proposed legislation, we reiterate that our position is based on actual sections of the Act as quoted in this letter. We also note that, once passed into law, the proposed legislation would be applicable to all gifts made after February 18, 2003.

An RCAAA is entitled, under the Act, to issue receipts for gifts that it receives. However, before an RCAAA can issue a tax receipt, it is incumbent on the RCAAA to determine whether the transaction qualifies as a "gift" at law. An organization which issues a receipt for a transaction which does not qualify as a gift at law, can be revoked under paragraph 168(1)(d) of the Act.

For this reason it remains our position that the Organization has issued receipts other than in accordance with the Act and which is, in and of itself, grounds for revocation of its registered status under paragraph 168(1)(d) of the Act.

Due Diligence

We have reviewed your letter dated October 29, 2009, in which you state, "[the Organization] could not disagree more with the CRA's allegation that the Board of Directors of [the Organization] failed to exercise appropriate due diligence in deciding to accept donations under the program." In support of this position, the Organization states that:

- Prior to agreeing to accept donations under the Program, the Organization engaged their legal counsel to review all relevant documentation;
- The Organization reviewed several legal opinions related to the Program;
- The Organization requested a number of changes to the agreement prior to signing; and
- Each year the Executive Committee and Board of Directors gave consideration to its continued participation.

Furthermore, your letter states: "It is forcefully submitted that [the Organization] met or exceeded the reasonable measures that it was legally obligated to take to investigate the legality of the Program."

We do not dispute that the Organization reviewed several legal opinions; however, as indicated in our previous letter, the Organization has refused to provide to the CRA the opinion issued by its legal counsel to the CRA, claiming solicitor/client privilege. The CRA is therefore unable to comment on the opinion provided, including whether it supports the Organization's decision to be involved. With regard to Organization's reliance on the opinion of BDO Dunwoody LLP and Mr. Edwin Harris, Q.C. of Patterson Palmer prior to entering into its first contract, we would note that both of these opinions were commissioned by and issued to the promoters of the tax shelter programs. The Organization's due diligence, or rather

reliance upon opinions issued to entities other than itself, is a contributing factor to the non-compliance identified in our audit.

We have reviewed the agreements signed by the Organization and have concluded that the agreement entered into by the Organization does not, in our opinion, constitute any significant changes that would alter the position of the CRA with regard to our opinion on the validity of the gifts by the participants in the tax shelter program. In reviewing the Series A 2004 Royalty Agreements the only changes found to the original issued by the promoter were the following:

- To Section 3.10, the following was added: "by or on behalf of the Association" with regard to TTL not being responsible for resulting losses;
- To Section 8.1(d), the following was added: "To the best of the Association's actual knowledge".

Finally, the mere fact that the Executive Committee and Board of Directors gave consideration to its continued participation in a program that historically returned less than 1% on the investment year after year does not, in our view, constitute proper duty of care for the protection of the assets under the Organization's control. In addition, it appears that the Board of Directors, in considering whether or not to continue participating, never invoked the Organization's right to receive the audit report to verify the monthly returns as *per* Section 7.2 of the Royalty Agreement.

Books and Records

We accept the Organization's proposal to address the filing requirements under Regulation 200(1) by ensuring that it provides T4A slips to all service providers that are paid in excess of $500 *per* calendar year on a going-forward basis.

Additional Points

The Organization raises additional reasons against the revocation of their status. Specifically, the Organization notes that it is willing to undertake to abide by any other provisions of tax-receipting policy that the CRA considers necessary or appropriate; that the Organization has always acted in good faith; and that the Organization is willing to implement the policies and procedures necessary to ensure compliance with all tax laws.

However, it is our position, as outlined above and in our previous letters, that the Organization had relinquished control over the amounts it transferred offshore and had relinquished control over how those sums were invested, thereby failing in their fiduciary duty of care for the assets of the Organization, and precluding continued registration.

The Act provides RCAAAs with the unique privilege of issuing tax receipts, which a donor can claim on his or her tax return, on the presumption that where funds are donated, the RCAAA actually receives and uses an equivalent amount in its programs. As it applies to the Organization, our audit has concluded the Organization has issued over $25.9 million in donation receipts through abusive arrangements in which leveraged donations were permitted to flow through the accounts of the Organization to an offshore account and

immediately returned to the original lenders. The Organization was entitled to retain directly a meagre 1% of all donations and received 0.17% *per* annum from its "investments".

It is regrettable that the RCAAA has chosen to participate in an abusive program. In our view, the conduct of the Organization is too serious to maintain its continued registration under the Act.

Appendix "B"

Flow of Funds

Re: The March 23, 2004 tax shelter closing F for Biathlon Canada

Upon review of the following documents the Canada Revenue Agency concluded that the funds were in fact repaid to the lender within a 24 hour period.

A diagram is attached (see Appendix B10) in order to help visualize the flow of funds between bank accounts of all parties involved for the closing F transaction on March 23, 2004, by the tax shelter promoter.

Steps involved:

Step 1 – Participants

A. Apply for a loan worth 112% of the intended donation receipt to 2036591 Ontario Inc. (known as Plaza Corporation on the loan application).
B. Send a cheque to Aylesworth LLP in an amount of $279 per $1,000 of the intended donation receipt. ($139,500 equals $279 multiplied by 500)

Note: no supporting documentation from the participants is included as it was deemed unnecessary to demonstrate the circular aspect of the loan.

Step 2 – 2036591 Ontario Inc. (the "lender")

A. Transfers $560,000, which represents the participants borrowed funds (see B2) to Aylesworth LLP as confirmed on the Aylesworth LLP's trust statement (see B4).

Step 3 – Aylesworth LLP (the "Trust")

A. Transfers $500,000 to Biathlon Canada; Closing F is confirmed as received by Biathlon Canada (see B6) and credited into Biathlon Canada's bank account (see B5).
B. Transfers $5,000 (1% of receipted amount by Biathlon Canada) to Specialty Insurance Limited (see B4).
C. Transfers $104,484 (see B4) to the Trafalgar Trading Limited's Bermuda account (see B9).

Step 4 – Biathlon Canada

A. Authorizes its bank to transfer $ 495,000 (99% of receipted amount by Biathlon Canada (see B7) for closing F directions to bank) from Biathlon Canada's bank account (see B5) and credited into Trafalgar Trading Limited's Bermuda account (see B9).

Step 5 – Trafalgar Trading Limited

A. Transfers $30,000 (6% of receipted amount by Biathlon Canada see B9) to the ParkLane Financial Group as a fundraising fee.
B. Transfers $562,800 (original loan amount plus .5% interest see B9) to 2036591 Ontario Inc.'s bank account as repayment of the loan (see B2).

Trafalgar Charitable Donation Structure