

**COPY****MAY 26 2006****BY REGISTERED MAIL**

National Childrens Burn Society
674 Kingston Road, Suite 1
Toronto, Ontario M4E 1R5

Attention: Mr. Thomas Reid

BN: 87196 3245 RR 0001
File #: 3005682

**SUBJECT: Notice of Intent to Revoke
National Childrens Burn Society**

Dear Mr. Reid:

I am writing to you further to our letter dated January 16, 2006 (copy attached) in which you were invited to submit representations to us as to why the Minister of National Revenue should not revoke the registration of National Childrens Burn Society (hereinafter, the "Charity"), in accordance with subsection 168(1) of the *Income Tax Act* (hereinafter, the "Act").

As we have not received a response to our letter, I wish to advise you that for each of the reasons outlined in our letter of January 16, 2006, and pursuant to the authority granted to the Minister in subsection 168(1) of the Act, and delegated to me, I propose to revoke the registration of National Childrens Burn Society. By virtue of subsection 168(2) of the Act, the revocation will be effective on the date of publication in the *Canada Gazette* of the following notice:

Notice is hereby given, pursuant to paragraphs 168(1)(b), 168(1)(d) and 168(1)(e) of the Income Tax Act, that I propose to revoke the registration of the organization listed below and that the revocation of registration is effective on the date of publication of this notice.

File Number	Business Number	Name
3005682	87196 3245 RR 0001	National Childrens Burn Society Toronto, Ontario

.../2

In accordance with subsection 168(2) of the Act, you can suspend this process (i.e. seek an extended period before revocation) by applying to the Federal Court of Appeal or a judge of that court for a stay. The Court will acknowledge your application and provide you with an action number. We require a copy of the Court acknowledgement of your request for a stay to stop the revocation process.

Should you wish to appeal this notice of intent to revoke the charity's registration in accordance with subsection 168(4) of the Act, you are advised to file a Notice of Objection within 90 days from the mailing of this letter. This notice is a written statement that sets out the reasons for the objection and all of the relevant facts. This Notice of Objection should be sent to:

Tax and Charities Appeals Directorate
Appeals Branch
Canada Revenue Agency
25 Nicholas Street
Ottawa, ON K1A 0L5

Please note that, notwithstanding the filing of a Notice of Objection, National Childrens Burn Society must seek the above-noted stay to prevent revocation from occurring. Unless the Canada Revenue Agency receives notice that an application for a stay has been filed to the Federal Court of Appeal or judge of that court regarding this revocation, we intend to proceed with the publication of the above notice in the *Canada Gazette* in 30 days thereby effecting the revocation of the organization's registration.

Consequences of a Revocation

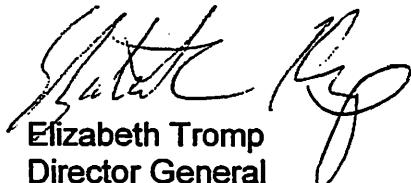
As of the date of revocation of the registration of National Childrens Burn Society, which is the date upon which the above-noted notice is published in the *Canada Gazette*, National Childrens Burn Society will no longer be exempt from Part I Tax as a registered charity and **will no longer be permitted to issue official donation receipts**.

Additionally, the Charity may be subject to tax pursuant to Part V, section 188 of the Act. By virtue of section 188 of the Act, National Childrens Burn Society will be required to pay a tax within one year from the date of the Notice of Intent to Revoke the Charity's registration. This revocation tax is calculated on prescribed form T-2046, "*Tax Return Where Registration of a Charity is Revoked*". The return must be filed and the tax must be paid on or before the day that is one year from the date of the Notice of Intent to Revoke a Charity's Registration. For your reference, I have attached a

copy of the relevant provisions of the Act (Appendix "A") concerning revocation of registration and the tax applicable to revoked charities as well as appeals against revocation. Form T-2046, along with the related Guide RC-4424, "*Completing the Tax Return Where Registration of a Charity is Revoked*", are also attached for your information.

I wish to advise you that pursuant to subsection 150(1) of the Act, a return of income for each taxation year in the case of a corporation (other than a corporation that was a registered charity throughout the year) shall without notice or demand therefore, be filed with the Minister in prescribed form containing prescribed information.

Yours sincerely,



Elizabeth Tromp
Director General
Charities Directorate

Attachments:

- Administrative Fairness Letter dated January 16, 2006
- Appendix "A" – Relevant provisions of the *Income Tax Act*
- Form T-2046, "*Tax Return Where Registration of a Charity is Revoked*"
- RC-4424 – *Completing the Tax Return Where Registration of a Charity is Revoked*



Canada Customs
and Revenue Agency

Agence des douanes
et du revenu du Canada

REGISTERED MAIL

January 16, 2006

National Childrens Burn Society
674 Kingston Road, Suite 1
Toronto, ON M4E 1R5

Your file / Votre référence

Our file / Notre référence
BN 871963245 RR0001
REG 3005682

Attention: Thomas Reid

Dear Mr. Reid

Re: **Charity Audit**

This letter is further to our audit of the books and records of account of National Childrens Burn Society (the "Organization"). The audit related to the operations of the Organization for its three fiscal periods ended December 31, 2001, 2002 and 2003.

The results of this audit and review indicate that the Organization is in contravention of certain provisions of the *Income Tax Act* (the "Act"). In order for a registered charity to retain its registration, it is required to comply with the provisions of the *Act* applicable to registered charities. If these provisions are not complied with, 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 Canada Revenue Agency's (CRA's) concerns.

Books and Records

Section 230(2) of the *Act* requires every registered charity to maintain adequate records and books of account at an address in Canada recorded with the Minister. The purpose of this requirement is to enable the charity to accurately provide CRA with the information required by the *Act* as well as enable CRA to verify the accuracy of reported information through the conducting of audits.

In addition to the retention of copies of the donation receipts that section 230(2) explicitly requires, section 230(4) also states that, "every person required by this section to keep books of account shall retain

- (a) the records and books of account referred to in this section in respect of which a period is prescribed, together with every account and voucher necessary to verify the information contained therein, for such period as prescribed; and

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(b) all other records and books of account referred to in this section, together with every account and voucher necessary to verify the information contained therein, until the expiration of six years from the date of the last taxation year to which the records and books relate".

A charity is not meeting its requirement to maintain adequate books and records if it fails to exercise due care with respect to ensuring the accuracy thereof.

It was found during the audit that the Organization's books and records were inadequate in the following areas:

- The following donation receipts were issued for cash donations, but no record was found to show when or if the individuals had made any donation:

- Nov. 27/03 - # 2003-BN1 -	\$9,500.00
- Nov. 27/03 - # 2003-VW-1 -	750.00
- Nov. 27/03 - # 2003-VW-2 -	750.00
- Nov. 27/03 - # 2003-VW-3 -	750.00
- Dec. 22/03 - # 2003-BN010 -	5,000.00
- Dec. 22/03 - # 2003-NB1 -	5,000.00
- Dec. 22/03 - # 2003-NB2 -	4,101.54
- Dec. 22/03 - # 2003-NB3 -	5,000.00
- Dec. 22/03 - # 2003-NB4 -	5,000.00

- A number of payments were made for which no documentation existed other than cancelled cheques or bank statement entries, and therefore it could not be determined what the expenses were for or whether they were incurred for a charitable purpose. The yearly totals for some of these payments were as follows:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
	\$12,663	\$25,872	
	7,296	12,810	\$12,489
	1,606	526	
	591		1,261
	2,247		
		7,336	13,120
		3,790	1,022
			7,822

Many other invoices were also missing.

- The charitable purpose of many of the expenses, e.g. Petty Cash receipts, could not be verified, as they were of a type that could easily be considered personal, e.g. gas bills, restaurant bills, liquor and beer expenses, etc. There was nothing noted on the invoices to indicate the purpose of the expenses.

- It is apparent from doing an analysis of the available daily payroll reports that many reports were missing. Also, no deposit records were provided that would allow for a reconciliation of the daily payroll reports to the bank deposits.
- No listing of donation receipts was provided that reconciled to "Total tax-receipted gifts" as reported on the T3010 Registered Charity Information Return. In order to determine whether the correct amounts had been reported, the receipts had to be listed manually by the auditor.
- A listing of gifts to qualified donees totalling \$100,500,000 for 2003 was not provided, and the available documentation could not be reconciled to the amount reported on the T3010.
- A number of donation receipts were missing, e.g. miscellaneous receipts amounting to \$76,759.40 in 2001 and most of the 2000-A series of receipts issued for artwork in 2001. There were also a number of serial numbers missing from the October 2, 2002 receipts that started with 02-10-22/001.
- It appears that there may be a series of donation receipts that were not provided to the auditor. We are aware of at least one such receipt - # 2002-T1 - that was issued for "Timeshare Property" for \$29,850 on Sep. 11, 2002.
- The system used to assign serial numbers to donation receipts indicates a lack of control over the serial numbers used. As different series of numbers are used, e.g. utilizing the date as part of the serial number, it would be difficult to know whether any series of numbers was missing, as in the previous situation noted. Please refer to paragraph 18 of Interpretation Bulletin IT-110R3.
- The financial statements provided bear little resemblance to the financial information reported on the T3010 returns. That is because the financial statements reflect only the transactions that occurred on the cash basis, whereas the main activity of the Organization, reported only on the T3010 return, appears to be receiving gifts in kind and giving them to other registered charities.
- Neither the T3010 return nor the financial statements reflect any amounts for inventory with respect to the works of art and software programs, etc received. If the amounts for which receipts were issued were accepted as being fair market value, the works of art on hand would be worth in excess of \$25,000,000 at December 31, 2003.

Under paragraph 168(1)(e) of the *Act*, the Minister may, by registered mail, give notice to a registered charity that he proposes to revoke its registration if it fails to comply with or contravenes section 230 of the Act dealing with Books and Records.

Official Donation Receipts

The audit indicates that the donation receipts issued by the Organization did not comply with the requirements of Regulation 3501 of the *Act* and Interpretation Bulletin IT-110R3 as follows:

- It is our position that the receipts issued for gifts in kind were considerably overstated, in that donors who purchased art prints, children's educational software programs or other software programs for relatively low amounts, gifted the prints or software programs to the Organization and received official receipts for amounts that were many times what the donors paid for them. We have obtained valuations from our Business Equity Valuations Section with respect to the children's software programs that were donated to the Organization in 2002 and 2003, which showed that the approximate values of the CDs were as follows:

	<u>2002</u>	<u>2003</u>
Blue Collection CD	\$37.30	\$29.40
Purple Collection CD	40.60	32.00

By contrast, the Organization issued receipts to donors based on a value of \$300 per CD in 2002 and early 2003, and a value of \$250 per CD for CDs donated to the Organization in the latter part of 2003.

With respect to the [REDACTED], the Organization issued receipts to donors on the basis of \$600 for each program received. However, it is our position that the fair market value per program was only \$120, which is what donors paid for the programs, and is also the amount that the Organization could have purchased the programs for. We have noted that a related organization, [REDACTED] made several purchases of the programs for \$120 each.

- Similarly, the amounts for which receipts were issued with respect to the prints should have been restricted to what the donors paid for the prints. It should be noted that a recent Federal Court of Appeal decision (Tolley, Quinn and Nash) determined that donation receipts issued to donors in similar situations should be restricted to the lower amounts that the donors actually paid.
- The Organization issued a number of donation receipts for gifts in kind with respect to works of art donated to it. No record was provided to show which works of art were donated, with the descriptions on the receipts merely stating "Gift in Kind Signed Numbered Prints". The only indications of the fair market value of the works of art were letters from Artistic Ideals Inc. stating what the art was valued at. However, without knowing which works were donated, it appears that the Organization would not have known whether the values provided were accurate.

According to Interpretation Bulletin IT-297R2, the fair market value of a gift in kind as of the date of the donation (the date on which beneficial ownership is transferred from the donor to the donee) must be determined before an amount can be recorded on a receipt for tax purposes. It is therefore our view that the Organization should not have issued official receipts before determining what the works of art were, so that their fair market value could be determined. This relates to official receipts issued for the following amounts:

-	2001	\$8,531,860
-	2002	2,329,518
-	2003	2,923,322

- It appears that numerous receipts were issued by canvassers for the mostly smaller donations they collected. The receipts did not state that they were official receipts for income tax purposes, as required by paragraph 16 of Interpretation Bulletin IT-110R3. However, they did contain the notation "Federal Charity Registration (letters patent) #344995-5, which could have given the impression that it could be claimed for tax purposes. If the receipts were meant to be temporary receipts or were not meant to be official receipts, they should not have included a registration number and should have contained a notation to the effect that "this copy is for your information only and is not an official receipt for income tax purposes", in accordance with paragraph 17 of IT-110R3.
- Official receipts issued in November and December of 2003 amounting to \$35,851.54 were issued for cash donations that could not be traced to deposit records (see details under **Books and Records**).

Paragraph 168 (1)(d) of the *Act* provides that where a registered charity issues an official receipt for a gift or donation otherwise than in accordance with the Act and regulations, the Minister may give notice to the registered charity that he proposes to revoke its registration.

T3010 Registered Charity Information Return

Subsection 149.1(14) of the *Act* requires every registered charity to file a Registered Charity Information Return, (form T3010), without notice or demand, within six months from the end of each fiscal period. This return must be in prescribed form and contain prescribed information. A charity is not properly meeting its information return filing requirements when it fails to exercise due care with respect to insuring the accuracy thereof.

The Organization did not comply with subsection 149.1(14) in the following ways:

- Based on the documentation provided, the amounts for which donation receipts were issued could not be reconciled to the amounts reported on the charity returns as follows:

	<u>2001</u>	<u>2002</u>
Total of all receipts per listings	\$17,466,419	\$50,603,418
“Total tax-receipted gifts reported on T3010 charity return	<u>8,955,000</u>	<u>47,797,518</u>
Understatement	<u><u>\$ 8,511,419</u></u>	<u><u>\$ 2,805,900</u></u>

The above amounts do not include receipts issued by canvassers (see note under **Official Donation Receipts**).

- There were also discrepancies in the amounts reported as non-cash gifts as follows:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Total receipts issued for gifts in kind per listing of receipts	\$17,389,660	\$50,603,418	\$93,370,822
Non-cash gifts reported (line 705)	<u>9,270,160</u>	<u>45,466,000</u>	<u>2,959,174</u>
Understatement	<u><u>\$ 8,119,500</u></u>	<u><u>\$ 5,137,418</u></u>	<u><u>\$ 90,411,648</u></u>

- Each return from 1998 to 2003 was filed after the expiration of the six-month period during which a registered charity is required to file.
- The amounts reported as “Total other gifts” on the returns reflect only the net proceeds after fundraising expenses, whereas the gross proceeds should have been reported. This also resulted in an understatement of the fundraising expenses. For example, gross revenue and fundraising expenses reported for 2003 were understated as follows:

- Actual fundraising expenses paid by cheque	\$10,177
- Estimated expenses paid out of door-to-door canvassing proceeds (estimated net proceeds was approximately 40% of gross proceeds based on sampling)	<u>111,214</u>
- Understated income/expenditures	<u><u>\$121,391</u></u>

- No list was provided of the gifts to qualified donees in the amount of \$100,500,000 for 2003. The available documentation could also not be reconciled to the amount reported on the return.

Paragraph 168 (1)(c) of the *Act* provides that where a registered charity fails to file an information return as and when required under the Act or a regulation, the Minister may give notice to the registered charity that he proposes to revoke its registration.

Disbursement Quota

In order to maintain its status as a charitable organization within the meaning of subsection 149.1(1) of the *Act*, a registered charity must, in any taxation year, expend amounts that are equal to at least 80% of the aggregate amounts for which it issued donation receipts in its immediately preceding taxation year.

The audit results indicate that the Organization failed to meet its disbursement quota, with the following shortfalls remaining after applying excesses from 1998, 1999 and 2001:

2000	\$202,694
2002	1,817,238
2003	26,277,720

See the attached schedule for details.

Expenditures used to meet the disbursement quota must be expended directly on a charitable activity. This would include such payments as salaries to persons performing duties directly related to a charitable program, but would not include amounts paid for purely administrative expenses such as fund-raising costs, legal or accounting fees and the like. Gifts to qualified donees are deemed expenditures on charitable activities.

We have recalculated the disbursement quota for the years 1998 to 2003, making the following adjustments:

1. Total tax-receipted gifts (line 100) for 2001 has been adjusted to \$17,466,419, as recalculated.
2. The amount of tax-receipted 10-year gifts (line 803) for 2001 has been adjusted to \$8,629,365 as recalculated.
3. Gifts to qualified donees (line 503) for 2001 to 2003 has been recalculated as follows:

2001

Gifts of [REDACTED]	- 625 @ \$120	<u>\$75,000</u>
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2002

Gifts of [REDACTED]	- 14,330 @ \$120	\$1,719,600
Gifts of Chidren's CDs – Blue Collection	- 45,600 @ \$37.30	1,700,880
Gifts of Children's CDs – Purple Collection	- 45,600 @ \$40.60	<u>1,851,360</u>
		<u>\$5,271,840</u>

2003

Gifts of Children's CDs – Blue Collection – 201,000 @ \$29.40	\$5,909,400
Gifts of Children's CDs – Purple Collection – 201,000 @ \$32.00	6,432,000
	<u>\$12,341,400</u>

The revised amounts for the children's programs are based on the fair market value determined by our Business Equity Valuations Section, while the revised values for the [REDACTED] are based on the donors' costs.

It should also be noted that we are not satisfied that all of the programs that were reported as having been gifted to hospitals were in fact proper gifts. Our auditors have visited several hospitals and made enquiries regarding the [REDACTED] and children's educational software that the Organization reported as having made gifts to. Most of the people that were contacted could not recall having received the CDs, and the one person that did recall receiving them stated that they were left in the lunchroom for employees to take home for free as they were considered to be of little value. Some of the hospitals also did not have Paediatric departments, to which all of the packages of CDs were addressed.

Paragraph 149.1(2)(b) of the *Act* provides that where a charitable organization fails to meet its disbursement quota in any taxation year, the Minister may, in the manner described in section 168, revoke its registration.

Statement of Remuneration Paid

The audit indicates that the Organization did not prepare and issue a proper Statement of Remuneration (Form T4) to its employees or a T4 Summary to CRA. In addition, no payroll deductions were made by the Organization for the employees and remitted to CRA.

Pursuant to section 153(1) of the *Act*, every person paying a salary or wages or other remuneration shall deduct or withhold therefrom such amount as may be determined in accordance with prescribed rules and at such time as may be prescribed, remit that amount to the Receiver General of Canada. Regulation 200(1) further requires that the person prepare Information Returns such as T4's at the end of the year.

The following are some of the larger amounts for which T4's should have been issued and deductions withheld:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
[REDACTED]		\$8,347	\$5,252
[REDACTED]n	4,997	18,753	18,547
[REDACTED]	1,850	10,300	1,700
[REDACTED]		1,979	4,160

It appears that a number of the canvassers, whose wages (commissions?) were paid by cash taken from the proceeds of door-to-door canvassing, would also be considered employees, and therefore they also should have been issued T4's and had deductions withheld and remitted.

The Organization has also conferred benefits on individuals, the value of which was not included on their Statement of Remuneration, Form T4. Specifically the Organization failed to report the benefits relating to the personal use of the Organization's leased or owned automobiles.

Automobile benefits for personal use occur when (a) an automobile is available to employees as long as they have access to or control the vehicle - access ends only when the automobile keys are returned; (b) the automobile is being driven for personal use by the employee or a person related to that employee including vacation travel, driving for personal business and travel between home and work (even if the charity insists that the employee drive the vehicle home).

Such benefits are required by paragraph 6(1)(a) of the *Act* to be included in computing a taxpayer's income for a taxation year from an office or employment.

You have stated that the Organization's vehicles were available for personal use by [REDACTED] office staff and crew managers of the door-to-door canvassers.

Pursuant to paragraph 168(1)(b) of the *Act*, the Minister may give notice to a registered charity that he proposes to revoke its registration where a registered charity ceases to comply with the requirements of the *Act* for its registration as such.

Conclusion

For each of the reasons indicated above in its own right, it appears to us that there are grounds for revocation of the Organization's status as a registered charity.

The consequences to a registered charity of losing its registration include:

1. The loss of its tax exempt status as a registered charity which means that the charity would become a taxable entity under Part I of the Income Tax Act unless, in the opinion of the Director of the applicable Tax Services Office, it qualifies as a non-profit organization as described in paragraph 149(1)(l) of the *Act*;
2. Loss of the right to issue official donation receipts for income tax purposes which means that gifts made to the charity would not be allowable as a tax credit to individual donors as provided at subsection 118.1(3) of the *Act* or as a deduction allowable to corporate donors under paragraph 110.1(1)(a) of the *Act*; and
3. The possibility of a tax payable under Part V, subsection 188(1) of the *Act*.

For your reference, we have attached a copy of the relevant provisions of the Income Tax Act (Appendix "A") concerning revocation of registration and the tax applicable to revoked charities as well as appeals against revocation.

If you do not agree with the facts outlined above, or if you wish to present any reasons why the Minister should not revoke the registration of National Childrens Burn Society in accordance with subsection 168(2) of the Act, you are invited to submit your representations **within 30 days from the date of this letter**. Subsequent to this date, the Director General of the Charities Directorate will decide whether or not to proceed with the issuance of a Notice of intention to revoke registration of the charity in the manner described in section 168 of the Act.

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

If you require further information, clarification, or assistance, please contact the undersigned at Canada Revenue Agency at the address or telephone number noted below.

Yours truly,



Henry Brunsved
Verification and Enforcement Division

Telephone: (519) 896-5933
Fax: (519) 585-2803
Address: 166 Frederick Street
Kitchener ON N2G 4N1

Enclosures