



Registered Charities Compliance

April 2019

Canada

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Overview

- CRA as the Charities Regulator
- What is a charity?
- Charities Directorate's approach to compliance and recent audit findings
- Past work on tax shelters and charities
- Foundations
- Compliance concerns
- Going forward and the challenges we face

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CRA as the Charities Regulator

- The Charities Directorate, within the Legislative Policy and Regulatory Affairs Branch (LPRAB), is responsible for all program activities related to the provisions of the Income Tax Act regarding registered charities.
- Main responsibilities: registration, client service, education, policy development, and responsible enforcement.
- The Compliance Division is responsible for the charities compliance program.

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Also regulates:

Registered Canadian Amateur Athletic Associations (RCAAAAs)

Registered National Arts Service Organizations (RNASOs)

Other listed qualified donees

Canadian municipalities

Prescribed universities

Public or municipal bodies performing a function of government

Low cost housing corporations for the aged

Certain foreign charitable organizations

What is a charity?

- The main advantages to being a registered charity:
 - Exemption from tax
 - Ability to issue official donation receipts for tax purposes
 - Eligible to receive gifts from registered charities
- Registered charities can be classified as either:
 - Charitable organizations or
 - Charitable foundations, which are further divided into:
 - Public foundations
 - Private foundations
- There are over 86,000 registered charities in Canada

So not only are charities not subject to income tax, they can issue receipts to donors for tax deduction purposes.

Charitable Organizations are typically charities that actually conduct some kind of charitable activity – eg. a hospital or a food bank

Charitable Foundations are charities that typically fund the charitable activities of charitable organizations, though they are still permitted to conduct charitable activities themselves. They are divided into public and private foundations based on their funding source and the relationships among their boards of directors. If a charitable foundation has many sources of donations and more than 50% of its directors deal at arm's length with one another, they would be classified as a public foundation – eg. sick kids foundation.

A charitable foundation will be considered a private foundation if more than 50% of its directors do not deal with each other at arm's length or more than 50% of the charity's funding comes from a person or group of persons that control the charity or make up more than 50% of the directors. There are separate, more restrictive provisions in the Act that specifically pertain to private foundation only.

Private and public foundations tend to be the “givers”, providing funds to the sector instead of carrying out their own charitable activities.

The number of private foundations is growing while the other designations remain fairly static.

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Compliance action

- CRA uses the following approaches to ensure charities comply:
 - Education letter
 - Compliance agreement
 - Sanctions
 - Monetary penalties
 - Suspension of receipting privilege
 - Revocation



Level of non-compliance

Audit findings

- Common reasons for revoking registration include:
 - Failure to devote resources to charitable activities
 - Carrying on unrelated businesses
 - Failure to be constituted exclusively for charitable purposes
 - Issuing receipts not in accordance with the Income Tax Act
 - Failure to maintain adequate books and records
- Charities have the right to object
- Revocations are published in the Canada Gazette

Objection process

The charities objection process is slightly different from the tax objection process in that objections skip the Tax Court and go straight to the Federal Court of Appeal (with the exception of objections to penalties, which then do go to Tax Court).

Tax shelters and charities

- In late 1990's, there was a significant increase in tax shelter identification numbers for gifting tax shelters
- Three main schemes were identified:
 - Buy low, donate high
 - Gifting trusts
 - Leveraged cash donations
- Compliance action found that a number of the gifting tax shelters were tax avoidance schemes, many involving foundations

When the Agency became aware of the schemes, immediate action was taken.

The CRA was committed to preserving the integrity of Canada's tax system, including protecting Canadians from abusive tax shelter gifting schemes, which included schemes where taxpayers received a charitable donation receipt with a much higher value than what they paid.

Tax shelters and charities

- Dedicated teams were created to address compliance issues resulting from these schemes
- CRA launched marketing campaigns to inform taxpayers of these schemes
- CRA denied more than \$7 billion in donation claims and reassessed over 208,000 taxpayer claims

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Most gifting tax shelter schemes were created for the primary purpose of avoiding the payment of required taxes rather than raising funds for charities.

The CRA continuously warned Canadians about non-compliant tax arrangements.

As a result of its multi-year, multi-pronged effort in deterring this form of non-compliance, the CRA has effectively eliminated mass marketed gifting tax shelters.

The CRA continues to use a risk-based approach to compliance to combat serious cases of non-compliance. In addition, the CRA educates taxpayers about the consequences of participating in abusive tax schemes, and works with the Department of Finance to close tax loopholes through legislative amendments.

Tax shelters and charities

- Assessed nearly \$200 million in third party penalties against promoters and tax preparers who advised on participation in these scheme
- Referrals made to criminal investigations
- No tax shelter identification numbers have been issued for gifting tax shelters since 2014 – schemes effectively eliminated

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Based on the Agency's results, this strategy is working.

Evolving role of foundations in tax planning

- Higher growth rate of private foundations when compared to growth rate of other registered charities
- High incidence of private foundations observed in high net worth population
- Number of foundations:
 - 5,065 public foundations
 - 5,743 private foundations

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Number of foundations is from February 2018

Foundations by the numbers

- Public and private foundations held about \$73 billion in assets in 2016, which is a 210% increase from 2008.
 - Private foundations \$41 billion
 - Public foundations \$32 billion
- Public and private foundations made \$5.7 billion in grants in 2016.
 - Private foundations granted \$2.02 billion
 - Public foundations granted \$3.66 billion

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Private and public foundations tend to be the “givers”, providing funds to the sector instead of carrying out their own charitable activities.

The number of private foundations is growing while the other designations remain fairly static.

As the population continues to age this trend will likely continue.

16(1)(c)

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The way forward

- Strategic partnership between Charities Directorate and High Net Worth Compliance Directorate
 - 16(1)(c)
- Modernizing the Agency's risk management of trusts
- Increased international collaboration

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T3 Task Force Committee;

Stratify trust population to better assess risk;

Efforts to increase audits in trusts, including foundations;

Foundations are tax exempt and can issue receipts for tax purposes. Greater scrutiny will be placed on these entities;

Strategic partnerships between Charities and Offshore to explore and address compliance concerns.

Visions and Objectives of the T3 Task Force Committee:

The vision of this strategy is to ensure that the CRA is well-positioned in the administration of the income tax legislation surrounding T3 trusts. With the implementation of this strategy, the CRA should be able to:

- Effectively segment the trust population and develop risk-typologies
- Capture accurate and complete T3 trust and beneficiary data
- Reduce the administrative burden for low-risk T3 trusts
- Accurately trace income allocated from a trust to the ultimate beneficiary
- Effectively risk-assess the T3 trust population and allocate resources accordingly

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- Provide better service and effectively address the highest-risk taxpayers with a well-trained, technically competent workforce
- Rely on a cross-branch corporate governance structure to coordinate and guide the administration of T3 trusts
- Regularly engage key external stakeholders to play an active role in CRA's administration of T3 trusts

The Committee followed these principles:

- Reduce the administrative burden for low-risk taxpayers
- Enhance targeted compliance of high-risk taxpayers
- Make it easier for all taxpayers to comply

For the T3 Task Force Committee, a report will come out and be presented to the AC and all DG's soon.

One of the recommendations of the committee is to stratify the trust population based on their nature to better assess risks and to re-design the instructions customized for each category. For example, testamentary trusts represent a much lower risk than mutual funds trusts.

16(1)(c)

Most foundations can issue charitable donation receipts, for tax purposes. This can lead the erosion of the Canadian tax base to different schemes that would take advantage of a foundation's ability to issue tax receipts. Offshore and Charities are collaborating to ensure that compliance concerns surrounding foundations are explored and addressed.

Challenges

- 16(1)(c)
- [REDACTED]
- [REDACTED]
- Potential impact on legitimate charities and foundations from negative publicity
- Legislative limitations

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Committee Input

- What indicators would help distinguish legitimate foundations from those created for tax avoidance purposes?

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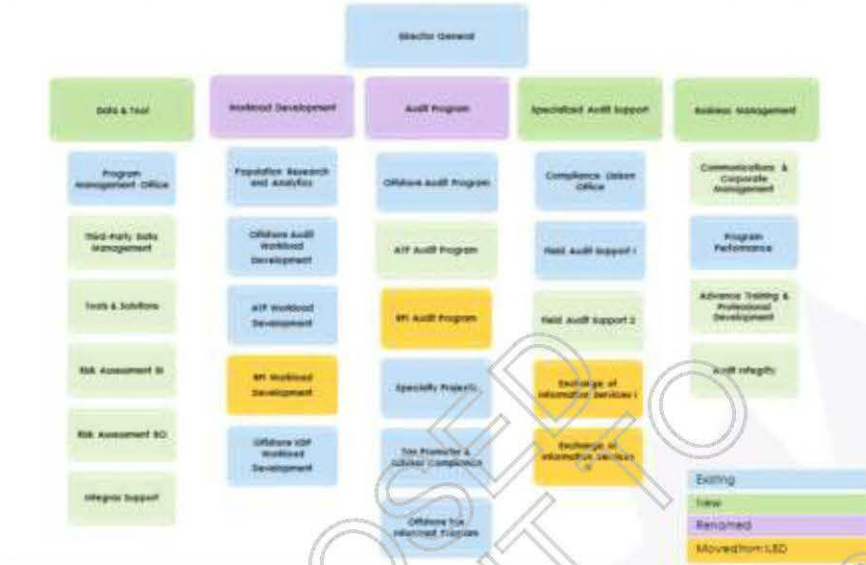
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Annex

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High Net Worth Compliance Directorate



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