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Jewish National Fund of Canada
(Keren Kayemeth Le'Israel)
1980 Sherbrooke Street West
Suite 500
Montreal, Quebec
H3H 1E8

Car file Note reference
24623
HAU 5608-8-1
Sean T. Kelly
Tel. (613) 954-1186

Attention: Saul Zitzerman
President

AUG 21 1989

Dear Mr. Zitzerman:

Re: Charity Tax Audit

Several months ago, an audit of the books and records of account of the Jewish National Fund of Canada (Keren Kayemeth Le'Israel) (hereinafter referred to as the "JNF") was conducted by a representative of the Department from the Montreal District Taxation Office. The audit related to the operations of the Organization for its fiscal periods ended December 31, 1984 and 1985.

The audit results indicate that the JNF may be in contravention of certain provisions of the Income Tax Act (hereinafter referred to as 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 by a particular registered charity, the Minister of National Revenue may revoke its registration in the manner described in subsection 168(2) of the Act.

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1. The JNF was granted status as a registered charity, effective January 1, 1967. In order to qualify for such registration the Association would have had to have met the definition of a "charitable organization" as set out in the Act. Subparagraph 149.1(1)(b)(i) of the Act defines a "charitable organization" as an organization, "all the resources of which are devoted to charitable activities carried on by the organization itself". The term "charitable", however, is not defined in the Act and it is necessary to refer to the principles of common law governing charity to determine whether a particular purpose or activity is charitable.

On this basis, charitable purposes have been categorized by the courts as the relief of poverty, the advancement of religion, the advancement of education and other purposes beneficial to the community as a whole in a way which the law regards as charitable. This latter category merely identifies an additional group of charitable purposes which have been held charitable at law rather than qualifying any and all purposes which provide a public benefit as charitable and is further restricted to such purposes benefitting the Canadian community, specifically.

Audit evidence indicates that the resources of the JNF may not be devoted to activities that are charitable at law. According to documents produced by the JNF, it appears that the JNF is raising funds for the express purpose of acquiring and developing land in Israel; projects described include the clearing and irrigating of land, the building of roads, the planting of trees and the erection of buildings for Jewish settlements. Charity Information Returns and Public Information Returns (Form T3010) filed annually by the JNF indicate that the purpose of the JNF is one of "Fund raising for the state of Israel" and that the activities of the JNF are undertaken to achieve that end. A charitable organization which devotes its resources to such activities would be acting in contravention of the Act.

2. Furthermore, it appears that the JNF has been funding other organizations rather than carrying on its own activities. In this respect, remittances were made during the 1984, 1985 and 1986 fiscal periods to a non-qualified donee (i.e., Keren Kayemeth Le'Israel in Jerusalem, 1984 - \$4,048,776, 1985 - \$4,109,800, 1986 - \$3,890,395).

In relation to the above observation, I remind you that a registered charity must devote all its resources to charitable activities carried on by itself. In order to view an organization as carrying on its own charitable activities, it is necessary that the charitable activities be carried on by an employee, agent, or through the participation by the organization in a partnership or joint venture of a charitable nature.

If an organization chooses to administer its own charitable activities through an appointed agent, an arrangement has to be established between the charity and its agent. To satisfy the requirement that an organization devotes its resources to charitable activities carried on by itself, funds transferred to an agent must be expended strictly in furtherance of the charity's own purposes. A satisfactory agency relationship does not exist where funds are provided by a charity simply to fund projects or a particular aspect of the projects of another organization. Furthermore, in carrying out its activities through an agent, a charity must ensure that the following conditions concerning the expenditure of its funds are fulfilled:

- (a) the charity must maintain direction, control and supervision over the application of its funds by the agent and title to any property purchased by the agent must be held by the charity;
- (b) the charity's funds must remain apart from those of its agent so that the charity's role in any particular project or endeavour is separately identifiable as its own charitable activity;
- (c) the financial statements submitted in support of the charity's annual information returns must include a detailed breakdown of expenditures made in respect of the charitable activities performed on behalf of the charity by its agent; and
- (d) adequate books and records must be kept by the charity and its agent to substantiate compliance with the conditions outlined above.

Direction, control and supervision include the concept of accountability by the agent to the principal. In turn, the principal must be able to account for how the funds were spent on its behalf by the agent. Records in support of such disbursements must be maintained at the principal's address in Canada.

In order for a registered charity to retain its registration, it is required to comply with the requirements of the Act relative to its registration as such. If the registered charity ceases to comply with the referenced requirements, paragraph 168(1)(b) of the Act provides that the Minister may give notice to the registered charity that he proposes to revoke its registration.

3. It appears that the JNF does not comply with paragraph 149.1(2)(b) of the Act which states that a charitable organization must expend in any taxation year, on charitable activities carried on by it and by

way of gifts to qualified donees, amounts that in the aggregate are at least equal to its disbursement quota for the year. The disbursement quota amount is defined pursuant to paragraph 149.1(1)(e) of the Act.

In this respect, it was observed that the JNF carried on no charitable activities by itself and made only gifts to qualified donees. It appears that the remittances to the Keren Kayemeth Le'Israel in Jerusalem, a non-qualified donee, were disbursed without direction, control, and accountability and as such, do not constitute charitable activities carried on by the JNF. The related disbursements therefore do not go towards satisfying the disbursement quota of the JNF for the 1984, 1985 and 1986 fiscal years. I refer you to the attached Schedule 1 which outlines the disbursement quota deficiencies.

Where a charitable organization does not expend an amount at least equal to its disbursement quota, on charitable activities carried on by it or by way of gifts to qualified donees, in any taxation year, the Minister may, pursuant to subsection 149.1(2)(b) of the Act, give notice to the registered charity that he proposes to revoke its registration in the manner described under section 168 of the Act.

4. Finally, it appears that the JNF is not in compliance with subsections 230(2) and 230(4) of the Act, which require a registered charity to keep records and books of account, together with every account and voucher necessary to verify the information contained therein, at an address in Canada recorded with the Minister. The audit suggests that records in support of "Remittances" made by JNF for the fiscal years 1984 and 1985, were not maintained at the offices of JNF.

Pursuant to paragraph 168(1)(e) of the Act, where a registered charity fails to comply with or contravenes any of sections 230 to 231.5 of the Act, the Minister may give it notice that he proposes to revoke its registration.

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 JNF would become a taxable entity under Part I of the Income Tax Act unless, in the opinion of the Director of the applicable District Taxation Office, it qualifies as a non-profit organization as described under paragraph 149(1)(1) of the Act;

2. loss of the right to issue official donation receipts for income tax purposes which means that gifts made to JNF would not be allowable as a tax credit to individual donors as provided by subsection 118.1(3) of the Act or as a deduction to corporate donors under paragraph 110.1(1)(a) of the Act; and
3. the possibility of tax exigible under Part V, subsection 188(1) of the Act.

For your reference, I enclose a copy of Information Circular No. 80-10R entitled "Registered Charities: Operating a Registered Charity" and I bring to your attention Appendices C and D which describe the provisions of the Income Tax Act concerning revocation of registration, the tax applicable to revoked charities and the appeal provisions from the Minister's issuance of a notice of intention to revoke a registered charity's registration.

If you do not agree with the facts and/or the reasoning described above, or if you wish to present your reasons as to why the Minister of National Revenue should not revoke the registration of the JNF in accordance with subsection 168(2) of the Act, you are invited to submit your representations to me by October 11, 1989. Subsequent to this date I intend to determine whether or not to recommend to the Director General, Registration Directorate that she should proceed with the issuance of a notice of intention to revoke the registration of the JNF in the manner described in subsection 168(1) of the Act.

Should you wish to appoint a third party to represent your interests, please notify me in writing.

If you have any questions on these matters, please telephone Sean Kelly at (613) 954-1186 or write to 400 Cumberland Street, Room 5004, Ottawa, Ontario, K1A 0L8.

Yours sincerely,



R.J. Macdonald
Chief
Audit Section
Registration Directorate

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Enclosure



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