
Chapter 3: Intermediate Sanctions

Background

De-registration is the main penalty in the *Income Tax Act* for charities that do not comply with the requirements. Once de-registered, an organization faces severe consequences. Not only does it lose the right to issue official donation receipts for the gifts it receives and, potentially, its tax-exempt status, it may also have to pay the revocation tax (Part V tax). This tax requires the organization to pay over an amount equivalent to its remaining assets to another charity or to the government.

Charities can appeal de-registration to the Federal Court of Appeal. The names of de-registered organizations are published in the *Canada Gazette*, and the Canada Customs and Revenue Agency's (CCRA's) letter setting out the reasons for de-registration is a public document.

The *Income Tax Act* also includes other penalties - including penalties for the misuse of certified cultural or ecological property and for inter-charity gifting that is used to cover up a failure to meet the minimum spending requirement (the "disbursement quota"). However these penalties are rarely used.

The Charities Directorate annuls the registrations of organizations which are and have always been non-charitable – those that were registered in error. These organizations do not have to pay the revocation tax. Annulments are always consensual, although if an organization does not agree, it faces de-registration and the revocation tax. If asked, the CCRA can reveal that an organization's registration has been annulled, but no other information about individual annulments is made public.

De-registration is an optional penalty. In practice, the Charities Directorate de-registers charities only if they:

- fail to file their annual return after repeated warnings; or
- are involved in serious or continued non-compliance.

As the following table indicates, few charities lose their registration for serious or continued non-compliance. A “voluntary” de-registration occurs when an organization is ceasing operations.

	1997	1998	1999	2000	2001
De-registrations: voluntary	782	623	727	914	613
De-registrations: failure to file	614	1087	886	2742	2097
De-registrations: “serious”	11	2	6	14	13
Annulments	1	2	7	13	14

On average, the Charities Directorate audits some 500-600 charities each year. Therefore, only 2% of audits reveal problems serious enough for the Directorate to proceed with de-registration or annulment. Roughly one in five audits show no problems or relatively minor ones. A further quarter results in an “education letter,” which calls the charity’s attention to the legal requirements. This leaves just over half the audits, where the result is to require a written promise by the charity to solve a problem, which the Directorate considers to be non-trivial but remediable.²⁹

A number of commentators have stressed the need for intermediate sanctions.

The Ontario Law Reform Commission’s *Report on the Law of Charities* (1996) proposed using penalty or excise taxes, either against the charity or culpable fiduciaries, taking into account the importance of the provision in question and the severity of the non-compliance. Taxes collected in this way could go either to defray the cost of administering the legislation or to other charities in the sector.

The *Report* also noted that the CCRA would have an effective lever to encourage compliance if charities had to get their blank donation receipts from the CCRA. The *Report* criticized the existing revocation tax as inconsistent with provincial trust law provisions. It recommended instead that a court transfer the assets of de-registered charities to another charity, and that these assets be protected in the

²⁹ While some organizations are selected for audit on a purely random basis, most are not. Therefore, no assumptions should be drawn from these figures about compliance patterns in the charitable sector as a whole.

meantime by making a type of sequestration or receivership available to the CCRA.

The Panel on Accountability and Governance in the Voluntary Sector (the “Broadbent Report,” 1999) emphasized the need for the CCRA’s compliance program to educate charities and give them a chance to resolve identified problems. It proposed a range of compliance actions, including providing information, publicity, and fines, before resorting to de-registration.

The Table on Improving the Regulatory Framework made a number of suggestions in *Working Together: A Government of Canada/Voluntary Sector Joint Initiative* (1999). A dispute resolution process should be available when the infraction is due to ignorance or when the infraction itself is in dispute. Among possible intermediate sanctions, *Working Together* recommended that monetary penalties apply only where a donor or a charity realizes an unlawful monetary gain. The right to issue official donation receipts could be suspended. Publicity can be a powerful sanction and could be combined with a system of formal orders directing a charity to comply. Any intermediate sanctions should be accompanied with an appropriate appeal mechanism.

In his paper “Federal Regulation of Charities” (2000), Patrick Monahan endorsed the proposals put forward in *Working Together*. Arthur Drache, in “Intermediate Sanctions” (1999), suggested a number of possible financial penalties. As a general rule, he would impose the penalty against the organization, rather than the directors or employees. However, if the non-compliance involved an improper transfer of property from the charity, the sanction should be on the person receiving the property.

Factors affecting the creation of a fair and effective sanctions regime

Compliance vs. sanctions

The purpose of a sanctions regime is to obtain compliance with the law. However, people’s compliance behaviour is not shaped just by the potential sanctions they face. Also involved is the perception that the penalties are legitimate, and that they are administered fairly and impartially. In practice, as well, the administrative feasibility of a

sanction comes into play. If it is too easy to apply, it may be used too readily; if it is too difficult to apply, it may be used erratically and unpredictably. In both cases, the sanction is unlikely to command the respect necessary to achieve voluntary compliance. Another range of factors in compliance behaviour relates to how complex the rules are and how well they are understood, and whether people have access to expert advice on how to comply with the rules.

Matching the sanction to the non-compliance

The legitimacy of any sanctions regime requires acceptance that the sanction is appropriate to the act of non-compliance. This implies ranking both sanctions and forms of non-compliance according to severity, and assuring an adequate match. It also involves finding a sanction that logically fits the type of non-compliance. If, for example, the type of non-compliance involves the abuse of the official donation receipts, then the penalty probably should focus on the tax-receipting privilege. Or if the cause of the non-compliance is ignorance of the law, then probably any compliance effort should focus on ensuring that the charity is made aware of its legal requirements.

How much discretion should there be in selecting the sanction?

This raises the further question, if more than one sanction is available, of who should be responsible for choosing the appropriate penalty. On the one hand, a case can be made for leaving a good deal of discretion in the hands of the regulatory body so that it can tailor a remedy to fit the case at hand. On the other hand, too broad a discretion leaves charities unsure of what the consequences of non-compliance will be, and opens up the possibility of disproportionate penalties. To avoid this, it might be better to specify the entire regime in detailed legislation that said if a charity does X, then the penalty may be Y. However, the consequence of giving the regulatory authority no discretion as to which penalty to impose is that this authority would also lack discretion not to impose a penalty. If a charity does X, the regulatory authority would have to impose Y, even if there were compassionate or other grounds why the penalty was inappropriate. The proper balance must be found between regulatory discretion, and clear and certain penalties.

What should be in the legislation?

Some may question whether it is even possible to spell out detailed sanctions in legislation. The sceptics will say that charity cases are almost always highly context-specific. Any legislative wording would have to be so general in nature that little certainty would be gained by the exercise. Also, charity law is continually evolving, and novel ways to abuse charitable status emerge regularly, so that the legislation would be continually out-of-date. To counter such arguments, others contend that it should be possible to devise statutory wording that lets charities know what they need to do. They would then at least have a list of all the requirements in one place, which they could periodically refer to as a self-check of their compliance status. Still, a remaining issue is how that list, once set in legislative stone, could be readily amended to match changing circumstances.

What sorts of sanctions are appropriate against charities?

There are a number of issues, especially with financial penalties. Typically, these involve complex legislative provisions, with considerable administrative machinery required to administer them. There is also debate on whether financial sanctions should be levied against the obvious candidate, the organization in question. Against whom do you levy a financial penalty if the charity has no corporate existence (such as a charity constituted as an association)? Why hurt blameless beneficiaries by depriving a charity of funds that would otherwise be spent on charitable programs? But if instead you levy the penalty on the directors or managers, what will be the impact on the recruitment of good people to these positions?

Another issue peculiar to charities is the tremendous variability of the sector. What one charity would consider a serious penalty may have little effect on another. For example, an endowed foundation that is no longer issuing tax receipts would not be affected by a penalty dealing with the right to issue these receipts. But how many different kinds of penalty are necessary? And at what point does the system become bogged down in complexity?

Transparency and public opinion

Yet another characteristic of the charitable sector that has to be borne in mind is its sensitivity to public opinion. If a particular organization is damaging the sector's reputation, perhaps there should be provisions enabling the regulator to promptly address the problem. Yet, presumably no one wants to see that organization's rights unnecessarily or improperly diminished. Public reaction also affects how transparent a compliance program should be. If it is made known that a charity is subject to a penalty, its reputation will suffer. However, without transparency, accountability for the operation of the compliance program becomes difficult and there is no way to reassure the public that an effective regulatory regime is in place.

Should de-registration remain?

If intermediate sanctions are introduced, will it be necessary to retain de-registration as a sanction? If so, should the existing revocation tax stay in its present form?

Who should impose a sanction against a charity?

If the regulatory body does this, then it is combining the roles of police, prosecutor, and judge. If another body at arm's length to the regulatory authority takes on this responsibility, then what sort of body should it be? And should this arm's length body impose all sanctions, or limit its sphere to only the more severe sanctions, lest the regulatory authority become hamstrung by another layer of bureaucracy? What avenues of recourse should a charity have if it disputes the decisions of the regulatory body (or those of an arm's length body)? How, in short, do you balance fairness to charities with an efficient sanctions regime?

Federal and provincial roles

As the Ontario Law Reform Commission has noted, charities are caught between federal and provincial regulation. The issue of regulatory overlap or gaps between the systems needs to be addressed in the context of compliance. A given problem brought to the attention of the federal regulator might be more properly or effectively handled at the provincial level, or vice versa. In another situation, a charity may

find itself with both provincial and federal regulators at its doorstep. Information-sharing, let alone a co-ordinated compliance program, between the various authorities is currently impossible, because each is required to operate under conditions intended to protect a charity's privacy. But is this sufficient reason to duplicate compliance expenditures at both levels, and to place a charity in a form of double jeopardy?

Other regulatory bodies

Somewhat similar is the question of what the federal charities regulator should do if it finds evidence of criminal activity or breach of another statute (such as the federal *Competition Act*). Should it have the authority to bring the evidence to the appropriate authority, on the grounds that the sooner the problem is taken care of, the quicker the potential damage to the charity, its beneficiaries, and the sector's reputation will be repaired? Or should the regulatory authority continue keeping its dealings with charities confidential, at least until such time as it imposes a sanction?

Reform recommendations

The purpose of a sanctions regime is to obtain compliance with the law.

Charities vary enormously in how they administer themselves, the degree of sophistication, asset base, sources of financing, and field of activity. Given this variation, we do not believe that a fair and effective sanctions regime can be achieved that relies only on a single penalty. We also believe that de-registration, currently relied upon as the sole penalty, is too severe for most types of non-compliance.

Obtaining compliance extends to a range of approaches that offer encouragement and support. In developing our proposals, we have assumed that most charities want to meet their legal requirements. Therefore, we have emphasized the need for the regulatory authority to work with charities to inform them of the law and to develop solutions to problems as they occur. The focus is on remediation – on putting things right. The aim is to make a charity stronger, not to drive it out of existence.

A graduated approach to compliance

Below is a description of four proposed levels (or “tiers”) of compliance actions, with Tier 1 having the least impact on a charity and Tier 4 the most severe impact. Generally, the regulatory authority would be expected to start with the least severe form of compliance action, and to only resort to more severe forms if this proves necessary. However, as both the severity of the penalty and the discretionary latitude increase, we will also be proposing safeguards to ensure the penalties are applied properly. The table below provides an overview of the four tiers.

Overview of Proposed Compliance Program

Severity of Compliance Action	Type of Compliance Action	Purpose of Compliance Action
Tier 1 (least severe impact on charity)	ADVICE/SUPPORT	To give a charity the information or advice it needs to meet its legal requirements
Tier 2	NEGOTIATED SETTLEMENT PUBLICITY (charity’s name is published on Website or local newspaper)	For the charity and regulatory authority to consider the charity’s specific circumstances and work out together how a problem can be resolved, with a commitment from the charity to resolve the problem accordingly To obtain compliance with the requirement to file an annual return, in a situation where the facts and law are self-evident, by enlisting the community to remind a charity of the legal requirements

<p>Tier 3 ("intermediate sanctions")</p>	<p>SUSPENSION OF QUALIFIED DONEE STATUS (charity could no longer issue tax receipts for gifts, receive grants from charitable foundations)</p> <p>FINANCIAL PENALTY ON CHARITY (charity loses its tax-exemption, with tax payable being up to 5% of previous year's income, or up to 10% for repeated infractions)</p> <p>FINANCIAL PENALTY ON INDIVIDUAL (individuals connected to a charity, with tax payable being the private benefit obtained, plus 25%)</p>	<p>Two purposes:</p> <p>First two sanctions: to obtain compliance, with the penalty being lifted once the charity meets the legal requirements</p> <p>All three sanctions: to provide a penalty for (and therefore deter) non-compliance, when the infraction is repeated, irreparable harm results, or private benefit is present</p> <p>Penalty amounts to be re-applied to charitable purposes</p>
<p>Tier 4 (most severe impact on charity)</p>	<p>DE-REGISTRATION</p>	<p>Replace existing revocation tax, to ensure assets are applied for charitable purposes</p>

Tier 1 compliance actions: Giving charities the means to comply

Charities must know and understand what is expected of them. Also, they should feel comfortable seeking guidance from the regulator when they are uncertain as to how to proceed. The regulator needs to:

- provide plain-language publications setting out the law,
- organize information sessions,
- promptly provide oral and written responses to questions posed by charities, and
- meet with individual charities at their request.

Charities need to know that they will receive correct information from the regulator and that they can come to the regulator for a frank discussion of problems. We propose that the regulator establish and publicize a policy emphasizing that its role is to help charities comply with the law. Also, the policy must ensure that the regulator, to the extent that its discretion allows, will treat charities leniently when they disclose their problems to the regulator and work with it to resolve the difficulty.

However, the regulator cannot be expected to handle a support role single-handedly. The sector can help by developing networks of charities. The network would bring charities together to share their knowledge and offer opportunities for the more experienced to offer guidance to the less experienced. We also recognize the need for courses, at community colleges and elsewhere, on the role of directors/trustees and charity law.

Tier 2 sanctions: Working with charities to correct a problem

Apart from education and support, negotiated settlements³⁰ should be a prominent part of the regulator's compliance program. Assuming that virtually all charities wish to comply with the law, these settlements should be sufficient to solve the problem in the vast majority of cases.

The core idea is to obtain agreement between the regulator and an organization about the nature of the problem, and what would put it right and prevent it from happening again. "Nature of the problem" includes the facts and the application of the law to those facts, as well as the reasons why the problem arose. Solutions must vary according to the circumstances at hand. Indeed, if they are to be appropriate, they must reflect the unique circumstances of the case. Such a procedure is modelled on that used in the United States and represents a development from the Charities Directorate's existing practice of obtaining a charity's written promise to correct a problem.

Both the regulatory authority and the charity should treat settlements as a mutual problem-solving exercise. As the two sides put their heads

³⁰ Strictly speaking, a negotiated settlement is not a "sanction," in the sense that it is not a penalty unilaterally imposed on a non-compliant charity. However, most charities would still probably regard the experience as one they would prefer to avoid.

together, creative ways of resolving a given problem will surely emerge. If necessary, they could agree to use an outside facilitator to help reach an agreement. The regulator should keep track of the various corrective and preventive solutions, evaluate their effectiveness, and develop a list of workable ideas for use in future settlement discussions.

Negotiated settlements attempt to solve problems that are specific to particular organizations. However, this is not a cost-effective approach to types of non-compliance that:

- occur frequently, despite the regulator's educational programs, and
- involve matters of fact and law that are not open to interpretation.

A good example of this type of non-compliance is failing to file the required annual information return. The law states that such a return must be filed, and either a charity did or it did not file the return. Some 2,000 charities are not filing their returns each year, despite a vigorous program of de-registering them for failing to do so.

As an aside, non-filing is a good example of why intermediate sanctions are necessary. The CCRA currently has no other practical means of enforcing the filing requirement short of de-registration. However, de-registration for active charities seems to be both overly severe and administratively unwieldy. Once de-registered, these charities have to re-apply for registration. This ensures the re-applicant meets current registration standards, but the application process is being used, inappropriately, as a form of penalty, and handling re-applications creates an additional burden on the system.

We propose that the regulator should initially use publicity, without first seeking a negotiated settlement, to handle non-filing of annual returns. When the names of non-compliant charities are published, pressure from the local community would serve as a reminder to the charity of its legal obligations. Publication could be on the regulator's Website, in a local newspaper, or both.

The regulator should telephone the charity and send it a written warning at least a month before the charity's name is published. No further action would be taken if the charity sends in its return before the date stated in the warning. If the charity has failed to advise the

regulator of a change of address or phone number, so that it does not receive advance warning, then the charity is responsible for the lack of warning.

On the regulator's side, system accuracy and frequent updating would be pre-requisites. Ideally, a defaulter's name should be removed from the list within a day or so of the return having been received and accepted. Procedures would also be needed to correct quickly (and publicize the correction of) any errors that occur in the listing.

If a Tier 2 compliance action does not correct the problem, the regulator can decide to seek a Tier 3 sanction.

Tier 3 sanctions: Penalties and inducing compliance

We propose introducing three types of intermediate sanctions:

1. suspension of a charity's status as a "qualified donee" under the Income Tax Act.

While suspended,

- the charity could not issue tax receipts for the gifts it receives;
 - other charities could not make gifts to it; and
 - people making a gift to the charity could not claim a tax benefit on the basis of their gift.
2. a financial penalty on an organization because it has temporarily lost its tax-exempt status. The tax payable would be up to 5% of the charity's previous year's income for first infractions, and up to 10% of this amount for repeat infractions.
 3. a financial penalty on individuals connected with a charity in certain circumstances, such as obtaining an inappropriate benefit as a result of their influence over the charity, or approving expenditures they know to be non-charitable. The tax would equal the amount of the benefit or expenditure, plus 25%.

We believe these different sanctions are required to handle a variety of circumstances. A financial penalty on a charity, for example, would be of no use against a penniless organization. Nor would it be meaningful to suspend the qualified-donee status of a foundation that is no longer issuing tax receipts. And if individuals rather than an organization are responsible, then it is appropriate for the penalty to fall on them rather than the organization.

Suspending qualified donee status is a novel sanction. It has a number of advantages, not the least of which is its logical fit with a federal regulatory regime based on the *Income Tax Act*. However, this sanction is difficult to enforce.

As a first step, the regulatory authority should publicize the names of suspended charities, with a warning to potential donors and granting charities. This would enlist the community to monitor the situation, and enable granting charities and donors to quickly check the status of charities that they are considering funding. The charity involved would also have to inform granting charities and donors of its suspended status before accepting any gift.

The regulatory authority should also investigate the possibility of obtaining control over tax receipts, and such a system should be adopted if its feasibility is established. “Control” implies a system under which the regulatory authority can track the organizations that are issuing receipts and which can effectively prevent an organization from issuing receipts if the organization is suspended.³¹ Such a system would also address the CCRA’s existing problems with counterfeit receipts issued by never-registered groups, and de-registered organizations continuing to issue receipts.

This sanction could be reinforced by imposing a financial penalty on charities that continue to issue tax receipts while under suspension. The regulator would also have the option of proceeding to de-registration if a suspended charity continued to issue receipts despite warnings to stop.

³¹ Several mechanisms for controlling receipts have been proposed. For example, for paper receipts, the regulatory authority could issue the blank receipt books itself or license their printing (as banks authorize the printing of cheque books). For receipts a charity issues electronically, it may be possible to flow the transaction through a “gate” maintained by the regulator.

After notice that the regulatory authority intends to impose a suspension, the organization would have 30 days to decide whether to seek recourse. (See below for the proposed recourse mechanisms for sanctions.) If the organization decides not to seek recourse, suspension would go into effect at the start of the first quarter after the 30-day period expires.

Financial penalty on charities. Conceptually, this penalty results from the loss of the organization's tax-exempt status. However, we believe that a charity's pattern of income and expenses are different from those of other taxable entities. It would be difficult, for example, for a charity to deduct much in the way of expenditures made for the purpose of earning income. Therefore, the suggestion is that the tax payable be set at up to 5% of the organization's income obtained from all sources in the previous year. Even if the organization has engaged in several forms of non-compliance, the penalty would remain at most 5%. However, if the organization subsequently repeats the same form of non-compliance, the penalty could rise to 10%.

After notice that the regulatory authority intends to impose a financial penalty, the organization would have 30 days to decide whether to seek recourse. (See below for the proposed recourse mechanisms for sanctions.) If the organization decides not to appeal, the penalty should become payable at the start of the first quarter after the 30-day period expires. The penalty would be payable quarterly; for example, if a total penalty of \$10,000 were imposed, \$2,500 would come due at the start of each quarter.

We are concerned that, wherever possible, charitable beneficiaries not be harmed by any financial penalty. Therefore, we propose that the money collected in penalties be turned over to charitable purposes. Various ways of doing this are possible. For example, the regulator might apply to the court system for a determination of where the money should go, with the court selecting a charity or charities in the area with similar purposes to that of the penalized charity. This procedure is probably too complex where relatively small amounts are involved, and so we suggest that, if less than \$1,000 is involved, the money should simply be payable to the Government of Canada.

Financial penalty on individuals. The existing *Income Tax Act* measures that encourage compliance are not always effective in

ensuring compliance by individuals who have significant influence over a registered charity's affairs. Provision for a financial penalty on directors, trustees, and certain employees of a charity could allow the regulator a more flexible and effective range of sanctions by focusing on specific individuals as well as the charity. As well, such a penalty has the advantage of not taking money from the charity itself.

Financial penalties on individuals are not intended to replace the Criminal Code. If a crime has been committed, then it should be prosecuted as a crime. Rather, we see certain fact patterns where these financial penalties might be useful. For example, a manager of a charity also owns a fundraising company; the charity awards a contract to this company; funds are raised in the name of the charity; and the company retains virtually all of the money. Or, a charity that has had its qualified donee status suspended continues to issue donation receipts, and the directors do nothing to correct the situation.

We are looking for advice on whether financial penalties on individuals should be introduced and, if so, what kind of situations they should apply to. Generally, we would expect that only individuals who participated in the activity, agreed to it or were negligent, would be penalized. Penalties could be based on the value of the funds wrongly disbursed plus an amount of up to 25% of those funds.

After notice that the regulatory authority intends to impose a financial penalty, the individual would have 30 days to decide whether to seek recourse. (See below for the proposed recourse mechanisms for sanctions.) If the individual decides not to appeal, the full amount of the penalty would become payable once the 30-day period expires.

As with financial penalties on charities, we suggest that any amounts over \$1,000 collected in financial penalties on individuals be re-applied for charitable purposes. The only distinction between the procedure given as an example previously for reapplying penalty amounts from organizations is that a charity that has suffered harm from the actions of the penalized individuals should be allowed to present a case for the penalty amount to be paid over to it. The regulatory authority may choose to contest this if it has evidence that the charity was negligent or partly responsible for the non-compliance.

Selecting the intermediate sanction. We have concluded that selecting the sanction to be imposed should be left up to the regulatory authority. It will often be obvious which is the most appropriate sanction. Where there is doubt as between suspending qualified-donee status and imposing a financial penalty on an organization, we suggest that suspension is preferable because it does not take from funds the charity has already collected from the public.

We would also allow the regulatory authority to apply more than one of the intermediate sanctions at the same time. Certainly it is possible to foresee circumstances where both the organization and individuals are equally to blame for the non-compliance. There may even be rare circumstances where both suspending an organization's qualified-donee status and imposing a financial penalty on it are called for, for example, a charity that is again abusing its tax-receipting privilege and has previously received a suspension for this reason.

Application of the intermediate sanction. These sanctions can serve two different purposes, as an inducement to comply and as a penalty.

As an inducement to comply, they are intended to persuade organizations to comply with the law. A charity would be able to avoid the sanction entirely if it satisfied the regulatory authority that it had corrected the problem before the date the sanction was due to go into effect. Once the sanction has gone into effect, it would run for a year, but the sanction would be lifted earlier if the charity complies at some point during the year.

We believe these sanctions should be used as a penalty:

- in the case of repeat offences, where the message that the charity must meet its legal requirements needs reinforcing;
- where the harm done to beneficiaries and public confidence in the sector cannot be undone; and
- where charitable status has been abused to the private advantage of individuals or to the damage of the public treasury.

In penalty mode, a sanction on an organization would be imposed for one year. It would continue to run even if the organization corrected its

problems in the course of the year. There would be no provision for avoiding the penalty.

Recourse. The procedures set out in the Appeals chapter for registration and de-registration decisions would also apply to the regulatory authority's decisions to impose intermediate sanctions. The individuals and charities affected could seek recourse by way of internal administrative review and afterwards from the court. The effect of seeking recourse would be to delay the imposition of the sanction.

We have some concern that recourse procedures not be used to unduly delay the application of justifiable sanctions. This is limited to some extent by the requirement proposed for all recourse procedures, that those affected indicate their intention to object within 30 days and that the internal administrative review is completed within 60 days, unless both parties agree to extend the process. Also, as discussed below, the regulatory authority would have the option of seeking an injunction from the court in cases where an individual's or an organization's ongoing non-compliance was creating irreparable harm.

The experience of other countries. The United States introduced new intermediate sanctions in the form of excise taxes in 1996 (those marked with an asterisk in the list below),³² although there were a number of pre-existing remedies in the *Internal Revenue Code*. Among the sanctions now available to the Internal Revenue Service are:

- a per diem fine on the organization for failure to file the annual return on time or filing an incomplete return;
- a fine of \$20 a day on an organization's employee, who refuses to provide a copy of the organization's annual return to a member of the public who has requested it;*
- a tax equal to a percentage of the amount spent on partisan "political activities" and of the amount above the allowable limit spent on "lobbying";
- a tax on income from unrelated businesses;

³² The new intermediate sanctions are being gradually phased in, and the Table is not aware of any analysis having yet been made of their effectiveness.

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- penalties on the organization for issuing inaccurate donation receipts as part of a promotion to understate tax;
 - a tax on persons in a position to exercise substantial influence over a charity's affairs for any "excess benefit" they receive from the charity;* and
 - taxes of varying rates against private foundations for engaging in self-dealing, for not meeting a minimum spending amount, for excess business holdings, for making imprudent investments, and for making payments for a non-charitable purpose.

The I.R.S. also uses its Website listing of charities to encourage filing on time, in that only the names of organizations that are up-to-date in their filing appear on the site.

The *Code* allows the I.R.S. to enter into "closing agreements" by which it can settle accounts with any taxpayer with finality. Organizations have a strong incentive to negotiate such an agreement, to avoid the loss of their tax exemption. (However, there is no equivalent to the Canadian revocation tax.) Such agreements can include payments to cover I.R.S. costs, but their chief aim is to prevent a recurrence of the problem. To that end, the I.R.S. will go deeply into an organization's operations and require, for example, the restructuring of its board. The closing agreement may also include a provision allowing for publication of the details as part of the settlement.

In England and Wales,³³ the Charity Commission does not exercise sanctions equivalent to the de-registration and revocation tax found in Canada. While the Commission can remove non-charities from the register, the focus of its efforts is on protecting charitable property and taking action against individual directors or trustees. Therefore, there are no financial penalties on organizations, although non-compliant charities are publicly identified.

In practice, the main sanction is holding an inquiry under section 8 of the *Charities Act 1993*. If the Commission's investigators find "misconduct" or "mismanagement" (the terms are not defined), the

³³ England and Wales form parts of a unitary state, unlike the federations of Canada, the United States, and Australia. Many of the powers exercised by the Charity Commission are assigned to the provinces under the Canadian constitution.

Commission can at its discretion invoke a wide range of powers that in Canada are associated with provincial jurisdiction, including:

- appointing a receiver and manager to replace an existing board;
- freezing the charity's assets;
- removing a director or employee; and
- making a scheme that could totally change the constitution of the charity concerned.

Charities are publicly identified when the results of section 8 inquiries are posted on the Commission's Website. The Commission is also now listing the names of charities that are two years behind in their filing requirements. The practice has become known as "naming-and-shaming."

It is also an offence under the *Charities Act*, punishable with a fine, for any "person" not to meet the filing requirements imposed by the legislation. Other offences are also identified. In these cases, the Commission hands the matter over to the police to lay charges. Provisions in the law allow for the free flow of information among the Commission, the police, and various governmental authorities, including the local authorities that license various forms of fundraising.

Tier 4 sanction: De-registration

In our view, de-registration must remain, as a last-resort sanction when all other compliance actions have been unsuccessful, or when the non-compliance is of a particularly serious nature and not capable of remediation.

Recourse, in the case of a proposed de-registration, would follow the procedures set out in the Appeals chapter and noted above in relation to intermediate sanctions.

However, we believe the existing revocation tax is flawed. It is unjust because of its disproportionate impact on some charities depending on their funding sources and the type of assets they hold. Further, as an attempt to protect tax-subsidized donations from being diverted to non-charitable uses, the provision is only loosely connected to this

objective. We have considered several reformulations of this tax, and found none to be satisfactory.

Instead, we believe the best approach is that recommended by the Ontario Law Reform Commission in its *Report on the Law of Charities* (1996: 379):

If de registration is applied as a penalty, then the one hundred percent penalty tax should be imposed in a way that ensures compliance with provincial *cy-près* law. There should also be some type of interim sequestration or receivership intervention available to CCRA. In both cases—deregistration and interim sequestration – CCRA should cede jurisdiction as soon as possible to the relevant provincial authorities.

The existing provisions for “voluntary revocations” should remain largely unchanged. These are requests by a registered charity that its registration be revoked. They occur when an organization is ceasing operations, so that any remaining assets should pass according to the dissolution clause in its governing documents. Such clauses are checked before registration to ensure that any remaining assets will continue to be applied for a charitable purpose. Nevertheless, the charity should be required to file a return with the regulatory authority, establishing that it has properly disposed of its assets. Where there is any question in this regard, the regulatory authority could seek an appropriate order from the court (see below) to direct the proper disposition of the assets.

It is unfortunate that a charity regulator must also occasionally deal with people who are less than honest, and whose actions potentially bring the sector into disrepute. Once the regulator is made aware of a potentially serious problem (for example, by a call from the local police), it has to go out and gather the evidence of such serious non-compliance as would justify a de-registration. Often the organization has not done anything that would clearly put it in breach of the legal requirements; it has simply been collecting money from the public.

The first clear-cut act of non-compliance comes when the organization cannot meet its disbursement quota, which usually falls some 30 months after registration. Add in the various delays for notices and establishing a hearing date, and another year could pass. At this point the organization (along with the money) typically disappears. It then

re-applies under a different name, with different people named as directors, and with an application that would arouse no suspicion.

To counter these cases, it would be useful to add another ground for de-registering a charity – that the registration was obtained on the basis of false or misleading information supplied by the organization in its application for registration. This measure would encourage everyone to take the application process seriously, but it is intended specifically to deal with organizations that use little or none of the funds they collect from the public for charitable work, and whose application for registration misleads both the public and the regulatory authority. Under the proposal, the regulatory authority would not need to establish the existence of non-compliance with the conditions for registration, only that the application was obtained on the basis of false information. The organization concerned would have the usual means of recourse.

Sometimes the regulator will see the same individuals who ran one registered charity off the rails turning up at its door with a fresh application. While naturally suspicious, the regulator may have no grounds to reject the application. The second organization then goes astray and is eventually de-registered. We seek advice on how this situation should be handled. One possibility is to introduce a requirement that a charity can not become or remain registered if a person occupying an influential position within the charity has, within the past five years, been convicted of fraud involving a registered charity or has been subject to the financial penalty on individuals, proposed above..

Special case: Annulments of registration

There are two related matters that are best considered separately. First are annulments. Annulling a registration means treating it as if it had never happened. The power to annul a decision is inherent in any regulatory body as a means of correcting a decision made in error. However, it would be advisable to spell out in legislation (or regulations) the situations when annulment is justified, to give a clear legislative basis for the CCRA's practice of not attempting to reclaim any tax advantages from either the organization or donors during the period before the error is discovered, and to provide a recourse

mechanism. The revocation tax (or replacement for this tax) should continue to be non-applicable to cases of annulment.

We propose that annulment of a registration be possible in cases where the registration was approved:

- as a result of an administrative error; or
- as a result of an application submitted in innocent error by an organization (for example, a subordinate entity mistakenly obtaining independent governing documents and applying for registration on the basis of them, when the constitution of its parent body does not permit the creation of independently established units within itself).

According to existing practice, annulments are consensual, and it may be desirable to make this a requirement in the legislation. However, if the organization disagrees with the regulator's assessment that it is not and has never been a charitable entity, currently it has no direct avenue of recourse.³⁴ The organization should have access to the recourse system to argue that it is indeed a charity.

All organizations that are under de-registration proceedings should also be allowed to use the recourse system to argue that they should not be de-registered, but rather their registration should be annulled, on the grounds that they never "ceased to comply" with their legal requirements and the regulator erred in initially granting them registration. Whether or not it makes its case, the organization will no longer be registered, but if it obtains an annulment it will not be subject to the revocation tax (or its replacement).

Special case: Orders

The second related subject involves the use of injunctions by the regulatory authority. Occasionally, the regulator is confronted with situations where immediate action is needed to protect the public interest or to prevent the loss of tax-assisted charitable assets. The actual or potential harm is of sufficient magnitude and irreversibility as to justify the regulator seeking a court injunction to curtail the damage until the matter can be sorted out under normal procedures.

³⁴ The organization has only an indirect means of recourse. It could refuse to accept the offered annulment, wait until the regulatory authority de-registers it, and then appeal.

This power already exists, albeit in undefined form. We propose giving a judge of the Federal Court Trial Division the power to issue such orders, and legislatively define “public harm” to include situations where there are reasonable grounds to believe that:

- tax-subsidized donations from the general public are not being applied for charitable purposes, or
- the general public is being misled either that they can use their contributions to claim a charitable tax benefit, or that their contributions will be used for a charitable purpose.

Spelling out the requirements in legislation

In our view, the requirements for registration are not spelled out clearly enough for charities (or even the regulatory authority) to easily understand the law.

We recommend deleting all the specific grounds for de-registration contained in the *Income Tax Act*.³⁵ Instead, there should be one general ground for de-registration: failure to comply with the requirements for

³⁵ The following table summarizes the specific grounds for de-registration listed in the Act.

Provision	Applies to	Grounds for de-registration
149.1(2)(a)	Charitable organizations	Carrying on an unrelated business
149.1(2)(b)	Charitable organizations	Not meeting disbursement quota
149.1(3)(a)	Public foundations	Carrying on an unrelated business
149.1(3)(b)	Public foundations	Not meeting disbursement quota
149.1(3)(c)	Public foundations	Acquiring control of a corporation
149.1(3)(d)	Public foundations	Incurring impermissible debts
149.1(4)(a)	Private foundations	Carrying on any business
149.1(4)(b)	Private foundations	Not meeting disbursement quota
149.1(4)(c)	Private foundations	Acquiring control of a corporation
149.1(4)(d)	Private foundations	Incurring impermissible debts
149.1(4.1)	All charities	Inter-charity gifting to avoid failing to meet disbursement quota
168(1)(b)	All charities	General provision: not meeting requirements for registration
168(1)(c)	All charities	Not filing annual return
168(1)(d)	All charities	Issuing improper donation receipts
168(1)(e)	All charities	Not keeping proper books and record

registration as a charity.³⁶ Then, a separate section should provide a complete, plain-language listing of what these requirements are, for example:

- to be resident in Canada,
- to file a return,
- to maintain proper books and records,
- to meet the disbursement quota, or
- to issue tax receipts properly.

To permit the legislation to adapt quickly to any new abuses, it should allow new requirements for registration to be introduced by regulation, although only within sufficiently specified areas (for example, with regard to private benefit), so that no undue discretion is given the regulatory authority in identifying compliance issues. Regulations could also be used to clarify some of the requirements, for example, by defining what “resident” in Canada means. However, if the government wishes to introduce any new provision that specifically calls for de-registration as the consequence for non-compliance, our view is that this should only be done by amending the legislation itself.

This represents more than a cosmetic change. First, many of the current specific grounds for de-registration (such as carrying on improper business activities, not meeting the disbursement quota, not keeping proper books and records, not filing the annual return, and issuing tax receipts improperly) are all forms of non-compliance that would be more effectively and appropriately dealt with by methods short of de-registration. Second, by singling out some types of non-compliance for special mention, the Act seems to say that these are the most serious breaches of the law, when in fact other types of non-compliance (such as conferring a private benefit or ceasing to operate in an exclusively charitable manner) may be more significant. Third, and this point applies not just in the context of de-registrations, the Act, as it is currently structured and worded, stands in the way of an effective compliance program. By placing all the requirements for

³⁶ This does not mean that ignoring any particular requirement would lead to automatic de-registration, but rather that the regulatory authority could decide as a last resort to de-register for non-compliance with any of the listed requirements.

registration in one place and by ensuring the meaning of each provision is clear, charities would better understand what is expected of them

Further simplification of the legislation may also be achievable by deleting certain existing penalties faced by charities and letting the problem be handled by the proposed intermediate sanctions. Among the provisions that could potentially be removed, for example, is the penalty against inter-charity gifting when used to evade the disbursement quota (ss. 188(3) and (4)).

Many other penalties in the Act target forms of non-compliance that charities may be implicated in, but are not exclusively directed at charities. These include, for example, improper disposition of ecological or cultural property (ss. 207.3 and 207.31); misrepresentation by third parties in tax planning arrangements (s. 163.2); and failure to remit source deductions (ss. 227.1(1)). In our view, it would be difficult to justify treating charities differently from others in regard to these penalties, which are designed to target specific infractions.

Co-ordinating the compliance regime with the work of other regulatory agencies

The regulatory authority's mandate currently extends only to the provisions in the *Income Tax Act*. What then should it do if its investigations disclose evidence that an individual connected with a charity is engaged in fraud or another offence? Or if these investigations strongly indicate that the charity itself is in breach of a statute (such as the *Competition Act*)? In our view, the answer is to allow the regulatory authority to disclose the evidence to the appropriate authority. Problems like this will almost always come to public attention anyway, and it is better for all concerned, including the reputation of the sector as a whole, that they be addressed.

More difficult is the case of what to do if the federal regulatory authority's investigations reveal a problem that falls partly or wholly within provincial jurisdiction. There is a good deal of overlap between federal and provincial roles, and the public is unclear which authority has responsibility for what. We suggest that public confidence in the sector is not helped by this lack of clarity. Charities also are often uncertain about the roles of the federal and provincial authorities.

Potentially, they could have investigators from both jurisdictions wanting to see their books at the same time.

We encourage the federal regulatory authority to enter into discussions with the provinces to explore opportunities to reassure the public and to reduce any conflicting demands and duplicative administrative burdens on charities. All governments would need to consider the advantages and disadvantages of allowing a freer flow of information among the various authorities.

Accountability and transparency in the proposed compliance regime

Accountability and transparency are a fundamental aspect of an effective compliance regime. However, it is important to note that the regulatory authority's first duty is to provide the individual charity in question with a full and prompt report of the findings from its investigations.

In considering what to publish and when, the potential harm to an organization's reputation has to be balanced against broader considerations, such as the following:

- reassuring the public, both by demonstrating the regulatory authority is active and by placing the dimensions of the problem, large, small, or non-existent, in the open;
- allowing the sector and the public to judge the regulator's use of its discretionary powers;
- providing a learning tool for both the sector and the public, by pointing out wider lessons in any reports;
- encouraging the community as a whole to serve as a watchdog; and
- creating an intermediate sanction, which we believe almost all charities would consider a powerful disincentive, but which is cost-effective, both in that it does not directly touch a charity's financial resources and in terms of how much it would cost to administer.

However, because of the power imbalance between the regulator and an individual charity, there is the danger that the regulator's definition of

the situation may be given undue emphasis. For this reason, our proposals on transparency are shaped to limit public reporting that names the charity involved to situations where:

- the facts and law are self-evident;
- the organization is not contesting the regulator’s interpretation of the facts and law; or
- a court has established the facts and law.

The following table uses the above criteria to summarize the proposed transparency regime.

Transparency in the Compliance Program

Compliance Action	Degree of Transparency by Regulator	Comments
Advice/support	None	The cases are likely to be numerous. While the facts and law are probably self-evident, the community watchdog role is unnecessary. The regulatory authority could use its annual report to describe these cases in an aggregate fashion without naming the charities involved.
Negotiated settlements	Reporting without identifying the charity	Although the facts and law are agreed to as part of the settlement, this type of compliance action presupposes a good-faith effort by both parties to resolve a problem. While reassurance of the public, full regulatory transparency, and the community watchdog role are potentially important in these cases, on balance we believe these factors do not justify the potential harm to a charity’s reputation that might result from naming it.

Publicity	List names of charities, with short explanation of the reason for listing the charity	The cases are likely to be numerous. The facts and law are self-evident. Publication is specifically designed to induce compliance.
Financial penalties and suspension	List names of charities or individuals, with a short explanation of the reason for imposing the sanction	The facts and law are likely to be contested, but publication would only occur after recourse rights have been exhausted. These decisions need to be published in a readily accessible fashion, because the public and the sector have to know particularly if qualified donee status has been suspended. Publication in this instance also serves as an additional inducement to comply.
De-registration	Full reporting identifying the charity	A report would only be published, with full details, after the charity has exhausted its recourse rights. A full report should also be given if a court overrules the regulator's proposed de-registration.
Annulments	List names of organizations, with a short explanation of the reason for the annulment	The facts and law would either be agreed to as between the regulatory authority and the organization, or determined in the recourse system.
Orders		These would be public unless the court directs otherwise.