Occasional Paper

The Appealing Illusion

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The Pemsel Case
FOUNDATION

"The law of charity is a moving subject"
– Lord Wilberforce

About Us

Named after the 1891 House of Lords decision, *Commissioners for Special Purposes of the Income Tax v. Pemsel*, [1891] A.C. 531, which established the four principal common law heads of charity used in Canada and elsewhere, The Pemsel Case Foundation is mandated to undertake research, education and litigation interventions to help clarify and develop the law related to Canadian charities. The Pemsel Case Foundation is incorporated under the Alberta *Societies Act* and is a registered charity.

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1. Introduction

For several decades, virtually everyone who has commented on charity law in Canada has said there needs to be a different way to handle appeals from decisions refusing registration of a charity or revoking an existing charity's registration.

Like many of these other commentators, The Pemsel Case Foundation believes that the existing appeal process needs to change – because it really isn't an appeal process at all. The right to appeal is, for reasons of cost and process, an illusion.

In this paper, we will discuss the increasingly common view amongst sector leaders and their advisors that these appeals should be heard by the Tax Court of Canada, and that they should involve a live (or *de novo*) hearing.

2. Why You Should Care

Considering that there are around 86,000 registered charities in Canada, the number of audits undertaken by the Charities Directorate of the Canada Revenue Agency (CRA) is quite small. But when they happen, the results can be devastating: you could lose the ability to give your donors receipts allowing them to claim tax credits and you could be forced to transfer all your assets to some other charity or, alternatively, to give them all to government.

Similarly, if you are an organization applying for charitable registration, you are likely a new group with a clear understanding of what you would like to accomplish. If your plans include obtaining financial support from the public, then the failure to obtain charitable registration could threaten all your plans.

If CRA decides against your organization, your chances of reversing that decision are very small. The system by which you can appeal the decision is, at best, challenging; at worst, it's an illusion to say that there is any real appeal. This paper will discuss the process, contrast it against the appeal mechanism used for almost every other dispute with CRA, and then conclude with what could – and perhaps, should – be.

There is an even larger reason you should care. The bulk of charity law is based on the common law. This means that courts look at the facts of a situation and come to a decision. Those decisions can be affected by changing social standards and views. The common law is meant to evolve as society evolves. But that evolution can happen only if there are cases that move the law forward. If there are few cases – as there are in the field of charity law – then evolution is stymied.

3. The Original Decision-Making

The registration and revocation processes have some similarities when a negative decision is going to be made. But the steps leading up to a decision are slightly different, so we will look at them separately.

Registration

An organization that wants to apply for registration as a charity will complete an application form online. That application, together with supporting documentation, is then considered by analysts within the Charities Directorate of CRA.

The most recent published report from the Charities Directorate covers the one-year period ending March 31, 2021.[1] In that period, 1,800 applications for registration were received. According to the report, 79% of the applications considered were approved.[2] Only 1% was refused registration. The remainder of the applications were abandoned or withdrawn.[3]

The report states that the most common reasons for refusing an application for registration are:

- the applicant proposes to engage in non-charitable activities[4]
- the application leads to concerns about private benevolence[5]
- the applicant proposes to act as a conduit for some other organization
- the application deals with only indirect protection of the environment
- the applicant proposes to provide resources to non-qualified donees[6]

During the review of an application, the examiner responsible for the file may pose questions to the applicant to understand exactly what it is wanting to do.

If the conclusion is that registration will be refused, CRA will send an "administrative fairness letter" to the applicant, setting out its tentative conclusions and the reasons for those conclusions. The applicant will be invited to make any additional comments. If the applicant doesn't respond, or if the response does not resolve CRA's concern, CRA will send a "final turn down" letter, refusing the application.

We do not know the exact reasons why a particular application was refused. Under the confidentiality provisions in the *Income Tax Act*, information about a refused application is not publicly available. Information would become available only if the organization releases it, or if the organization appeals the decision, in which case the documents become available as part of the court record.

Revocation

Almost all revocations of an organization's status as a charity for substantive reasons follow an audit.[7]

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[1] https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/about-charities-directorate/report-on-charities-program/report-on-charities-program-2020-2021.html. Last accessed July 5, 2023.

[2] This number may not relate directly to the 1,800 applications, since a decision may be rendered in a different fiscal year than the application was received.

[3] Some of these applications may have been withdrawn or abandoned because of a sense the application would otherwise be rejected. Because of the confidentiality provisions in the *Income Tax Act*, information about unsuccessful applications cannot be released.

[4] Note that this does not suggest that the application does not have charitable purposes, but the activities it proposes to undertake may not be charitable. The distinction between purposes and activities is an ongoing debate.

[5] The report does not make clear whether this relates to the proposed beneficiaries being too narrow a group and thus not meeting the "public benefit" test, or whether the concern is around possible undue private benefits to some person or organization.

[6] This may not be a significant issue in future, given amendments to the *Income Tax Act* in 2022 that now allow charities to make grants to non-qualified donees.

[7] The vast majority of revocations of charitable status are due to the charity failing to file its annual return, the T3010 form.

The 2020-21 Charities Directorate report showed that 142 audits took place in the reporting period, and only four charities were revoked for cause.[8] The report notes, however, that the low number of revocations for cause was influenced by the pandemic restrictions. The previous report, covering 2018-20, does not include detailed numbers for the Directorate's compliance work. So, despite the fact that changes in processes have occurred in the interim, we must turn to the 2016-18 report,[9] which shows 54 organizations had their charitable status revoked over that two-year period. This is a much smaller number than the 1,766 organizations which voluntarily gave up their charitable status, or the 1,086 that were revoked for failure to file their annual return.

Table 1, below, shows the results of audits that the Charities Directorate closed in the 2016-2018 period.

TABLE 1

Result	2016	2017	Total
Education letter	387	313	700
Compliance agreement	142	92	234
No action required	38	51	89
Voluntary revocations	17	35	52
Notices of intention to revoke	**39**	**25**	**64**
Other	21	27	48
Sanctions	3	5	8
Annulments	5	0	5

Once an audit is completed, the Charities Directorate writes to the charity and advises it of its audit findings and what action, if any, it proposes to take. This is what is called the administrative fairness letter, and sets out the findings and each ground on which CRA proposes to take an action – whether that is imposing a sanction or revoking the registration of the charity. A charity may provide additional arguments or comments to the Charities Directorate, hoping to change the preliminary decision. The Directorate will respond and determine whether it will change its view. If not, the Directorate proceeds to publish the notice of revocation in the Canada Gazette and, at that point, the registration is officially revoked.

In some cases, the Directorate may agree to withhold publication, thus suspending the revocation while the charity pursues first an objection and then an appeal. However, that is a decision that is solely within the discretion of the Directorate. There have been some cases where the Directorate has refused to withhold publication, and the charity has gone to court to try to delay the publication and revocation. Charities have not fared well in those cases. In the most recent case,[10] the Federal Court of Appeal once again found that the charity was unable to prove that it would suffer irreparable harm if the revocation proceeded.

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[8] Again, the number of audits and the number of revocations can't be directly compared, because the revocation may take place in a different fiscal year than the audit.

[9] https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/about-charities-directorate/report-on-charities-program/report-charities-program-2016-2018.html#toc16. Last accessed July 5, 2023.

[10] *Sheldon M. Chumir Foundation for Ethics in Leadership v. Minister of National Revenue*, 2023 FCA 242. In this case, the court did not even call upon the government to respond to the charity's arguments.

We turn now to the appeal process.

4. Appeals – Part One

Like every other taxpayer,[11] an organization that is refused registration or has its registration revoked can appeal the negative decision.

For charities, or organizations trying to become a charity, the first step in the appeal is the same as for any other taxpayer objection to a CRA decision. The organization must file an "objection" to the decision and ask that the decision be reviewed by CRA's Appeals Branch. This is a group that operates independently of the earlier decision-makers – in this case, the Charities Directorate.

Officials in the Appeals Branch can consider new information provided by an organization, it can gather information on its own, and it is not bound by the previous decision. It can, without reference back to the original decision-maker, reverse the initial decision. In the case of charity files, that means the Appeals Branch can direct that an organization be registered as a charity, or can withdraw the notice of intention to revoke the registration of a charity.

Beyond that, we know little of what happens with charity-related appeals once they enter the Appeals Branch. Because of the confidentiality provisions of the *Income Tax Act*, information about that experience is available only if the organization reveals it. CRA will not even confirm if a file was considered by the Appeals Branch. There appear to be no publicly available statistics indicating the results of Appeal Branch considerations, and certainly none that relate to files involving charities or organizations wishing to be charities.

In response to a recent request under the *Access to Information Act*, the Appeals Branch did provide some statistical data related to objections filed by organizations that had had their charitable status revoked, or had been refused registration as a charity. The response redacted information related to appeals involving revocation, citing a statutory prohibition on release.[12] It did, however, provide information about objections in cases where an organization had been refused registration. That data show that in the 10 years beginning March 1, 2013, 92 such objections had been received. In that same period,[13] 60 refusals had been confirmed, 31 refusal decisions had been vacated, and five objections had been ruled invalid, presumably because they were not filed in time.

In some cases, however, we can make some assumptions. Recently, an organization had its charitable status revoked. Under the *Income Tax Act*, once a revocation becomes official (i.e., is published in the Canada Gazette), information related to the revocation is available on request to CRA. In this particular case, the documents released by CRA show that the administrative fairness letter was issued July 3, 2012 and the final notice confirming the intention to revoke the registration was dated August 2, 2013. However, the notice of revocation was not published in the Canada Gazette until March 25, 2023 – almost a decade later.[14]

If the Appeals Branch doesn't reverse the original decision, the next stage of appeals makes charities different from most other taxpayers – and that is the source of concern.

[11] A charity or an application for charitable registration are considered taxpayers for the purposes of the *Income Tax Act*.
[12] A complaint has been made to the Information Commissioner asking for a review of this decision by the CRA.
[13] Not all decisions of the Appeals Branch are made in the same year that an objection was received.
[14] The records of the Federal Court of Appeal show that the organization involved filed an appeal in that court on September 5, 2013 – a month after the notice of intention to revoke – but discontinued the action the following month.

5. Where Do You Go (or Not Go) From There?

For almost all people (or corporations) that disagree with CRA's final decision, their next opportunity to get satisfaction is at the Tax Court of Canada.[15] Not so for cases involving charitable registration or revocation: those cases go to the Federal Court of Appeal.[16]

There are a number of differences between the two court systems, including rules of practice and procedure, locations, fees, and so on. There are also different rules about who can represent the organization that has filed the appeal; it is generally easier to get permission in the Tax Court for a member of the organization to represent the group than it is in the Federal Court of Appeal.

But the most important one for cases involving charities is how evidence is presented.

In the Tax Court of Canada, evidence is presented primarily through witnesses. The person or organization filing the appeal is entitled to give testimony and to call others to help make their case. Similarly, government officials can call their witnesses, usually auditors. This is called a hearing *de novo*. That means that the only thing the judge knows about the case at the outset is what is contained in the notice of appeal and the government's response. Most of what a judge learns will come from the witnesses.[17]

In the Federal Court of Appeal, the hearing is presided over by three judges, and they focus only on the written record. That record consists of whatever documents the organization submitted to CRA, and any records generated by CRA, whether through an audit, correspondence, or other material. The Federal Court of Appeal does not hear from witnesses.

The record that goes before the court is prepared by CRA, and it will include any information that was relied upon to make the decision. The organization that has filed the appeal has no opportunity to question CRA officials about any of the material in that record. If the organization hasn't made an argument in its written submissions to CRA, that argument is not likely to be allowed to be raised in front of the Federal Court of Appeal. If even one ground that had been raised in the administrative letter is proven, the court can dismiss the appeal and allow the revocation to proceed. This could lead to the (arguably absurd) result that the court finds that CRA has not proven that its major complaint about the charity is valid, but the charity could still be revoked because it had not kept appropriate books and records.

The biggest disincentive is the matter of cost, and the time required for an appeal to be heard is also a problem. Lawyers who work with charities estimate that taking a case to the Federal Court of Appeal would cost at least $100,000, and probably much more. It would be a rare case where a law firm would agree to take on the case on a pro bono basis. If an organization is seeking charitable status, chances are that it won't have anything close to that amount of money available to them. Even an existing charity facing revocation may not have enough money to take their case forward. In both these situations therefore, these organizations have no real recourse so that they can have their case heard by someone outside of CRA.

[15] Cases involving registered Canadian amateur athletic associations, and plans that have been denied registration by CRA must take their appeal to the Federal Court of Appeal.

[16] Incongruously, cases where CRA has imposed an intermediate sanction on a charity (such as a fine or suspension of receipting privileges) can be appealed to the Tax Court of Canada.

[17] Other countries, including Australia and New Zealand have made clear that appeals of this type are to be treated as hearings *de novo*. In the United States, the type of hearing depends on the court in which the appeal is filed.

It is not clear how much less the cost would be if appeals were heard by the Tax Court. In part, that is because the Tax Court would have to develop its own set of rules on hearing charity appeals. This could be done through something similar to the court's informal procedure, or it may need to be done under the court's general procedure, which is more formal and more expensive. There would be costs that aren't faced in the Federal Court of Appeal simply because the case would involve witnesses – so the benefit of having a more substantial record, through the live testimony of witnesses, may well be offset by the additional costs of having to have lawyers in the courtroom longer to present that evidence.

Such a change might well increase costs to government. If more appeals are filed because the cost to the appealing organization is lower, government would have to defend more cases, and that would result in increased costs being borne by government and, ultimately, taxpayers. One could argue, though, that if the Appeals Branch is overturning decisions before they enter the court system, the increased number of appeals might be minimal.

There is another more pragmatic issue involved. Very few charity cases that have gone to the Federal Court of Appeal have resulted in a decision favourable to the charity or aspiring charity. This may well be because CRA usually "gets it right" or it may be because the full cases are not in front of the court, or it may be that the cases that have been taken just have bad facts. So when deciding whether to take a case forward, an organization has to assume that it will face an uphill battle at the Federal Court of Appeal, and question whether its case is strong enough that it might be able to persuade the Supreme Court of Canada to take up the case. That, of course, just ups the ante.

In essence, then, because of the restricted evidentiary base, and the cost, an organization refused charitable registration or facing revocation has no real opportunity to have its case heard by someone outside of CRA. We do not know how the internal appeal procedure in CRA is dealing with charity cases, so cannot even guess at how effective a mechanism that is.

What we do know is that the common law of charity has not evolved in Canada for decades. We lag far behind other common-law jurisdictions and for one very simple reason – we can't get cases to court on the merits.

Moving the appeals, in the first instance, to the Tax Court of Canada, and decreeing in legislation that the case will be heard de novo is the best chance that exists to develop a body of jurisprudence that will help the concept of charity evolve to meet the situation faced in 21st-century Canada.

6. An Interesting Alternative - Sometimes

In two recent high-profile cases, lawyers on behalf of charities were able to find a way around the current ineffectual appeal process. They have brought their cases not on the basis of charity law, but on the basis of alleged violations of the *Charter of Rights and Freedoms*. This means that they have been able to take the cases to a provincial superior court (in both cases, the Superior Court of Justice in Ontario) and present evidence through witnesses and other documentation that goes well beyond the record that normally exists in a charity appeal.

In the case of *Canada Without Poverty v. Attorney General of Canada*,[18] the charity challenged CRA's definition of what constituted a political activity and argued that definition breached its right to freedom of speech. The court agreed and declared that the interpretation and enforcement of certain parts of the *Income Tax Act* breached the Charter.[19]

In a more recent case, the Muslim Association of Canada brought an action in the Ontario Superior Court of Justice.[20] The Association had been audited by CRA and an administrative fairness letter issued, saying CRA believed it had grounds to revoke the Association's charitable status and to impose financial penalties. The Association claims

> that the CRA audit has been tainted by systemic bias and Islamophobia. MAC alleges that the audit has been conducted in a manner that violates its rights under ss. 2(a), 2(b), 2(d), and 15 of the *Canadian Charter of Rights and Freedoms.* MAC seeks an order, pursuant to s. 24(1) of the *Charter*, terminating the audit or directing that the audit proceed in a *Charter*-compliant manner.[21]

In both of these cases, the introduction of evidence beyond CRA's record would be critical to understanding the issues and coming to a conclusion. That could not be accomplished within the normal appeal system.

The number of charity cases that raise Charter issues is probably small, but these Ontario experiences where Charter jurisprudence is being overlaid on charity law raise interesting possibilities that are well beyond the scope of this paper. Yet, it is worth noting that Charter cases are intended for a different purpose than to resolve the many unresolved issues in charity law. Constitutional cases are meant to set the boundaries on what actions the state may take without inappropriately infringing on the rights of Canadians. Those rulings, in the most part, will be peripheral to the concerns about ambiguities in the law related to charities. Even in the *Canada Without Poverty v. Attorney General of Canada* case, it is important to note that this was a decision of a trial court, and did not withstand appellate review. Rather than appeal, the government amended legislation to remove limitations on advocacy, instead creating a wider (and welcomed) permission for charities to engage in public policy dialogue and development.

[18] 2018 ONSC 4147.
[19] Subsequently, the *Income Tax Act* was amended to remove reference to "political activities" and introduced the concept of "public policy development and dialogue activities" which are considered to be charitable, without limitation, so long as they meet certain requirements and avoid becoming partisan.
[20] *Muslim Association of Canada v. Attorney General of Canada 2023*, ONSC 1923 (procedural ruling). The case was subsequently dismissed on the grounds of prematurity. 2023 OSNC 5171. An appeal of that decision has been filed with the Ontario Court of Appeal.
[21] *Ibid* para 8.

7. Conclusion

In Canada, the state of charity law has effectively stagnated and that is, in large part, due to the fact that courts have not been called upon to advance the common law as they are meant to do. But the courts can't do that if there are no cases brought before them.

The fact that cases are not brought before them, in turn, is caused by the fact that the current appeal system is complicated, expensive, and may not deal with the real issues involved, because evidence of those real issues may not be able to be brought before the court.

In essence, therefore, the appeal system that exists in Canada is an illusion. It's there, but for most organizations, it's not usable.

There is no guarantee that decisions in the Tax Court of Canada would be any more advantageous to charities, or organizations hoping to be charities. But the broader ability to hear evidence, the more convenient locations for sittings and, potentially, lower costs, might mean more cases are heard, so that the common law can develop.

It is obviously in the interests of any government to limit how its decisions may be reviewed. In the case of charity law, however, it's not clear that the current rules operate in the interest of the broader public that could benefit from the work of charities.

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