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Guidelines for applying sanctions

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Introduction

The purpose of a sanction is to encourage compliance with the requirements of the Income Tax Act. Until recently, the only tool the Canada Revenue Agency (CRA (Canada Revenue Agency)) had to enforce these requirements for registered charities was to take away ("revoke") a charity's registration. This was widely recognized as overly severe for many forms of non-compliance. The government and charity representatives who sat together on the Joint Regulatory Table recommended the introduction of less severe, "intermediate" sanctions.

Amendments to the Act have now created a number of these additional sanctions. They apply to non-compliance occurring during a charity's fiscal period that began after

March 22, 2004. (For example, a charity that started its fiscal period on April 1, 2004, could be subject to a sanction if it broke the rules on or after April 1, 2004.)

This document describes the types of non-compliance and the sanctions specified in the legislation but first let us look at how the Charities Directorate proposes to use the provisions.

General approach

Ranked in terms of their potential severity, the tools the Directorate can use to obtain compliance are:

- Education (for example, by making written advice available in publications and on this website, answering questions from individual charities, and offering advice during an audit) - An audit may result in what is called an "education letter" that explains the rules to a charity.
- Compliance agreement - Such an agreement is reached through discussion with, and agreement from, the charity. The terms of the agreement are spelled out in a formal document called a

compliance agreement that is signed by both the charity and the CRA (Canada Revenue Agency). The agreement identifies the problems, the steps the charity will take to bring itself into compliance, and the potential consequences to the charity of not abiding by the agreement.

- Sanction – A financial penalty, or a suspension of the charity's status as a qualified donee along with its ability to issue official donation receipts.
- Revocation of the charity's registration.

As a general rule, the Directorate intends to start with educational methods to obtain compliance, and then move progressively through compliance agreements, sanctions, and the ultimate sanction of revocation, if necessary. However, the Act allows us to select the tool appropriate to the circumstances. As such, in serious cases of non-compliance, we are prepared to move directly to a sanction or revocation.

Serious cases of non-compliance include those where:

- the non-compliance reaches certain thresholds (either in absolute terms, such as the dollar value of expenditures on non-charitable activities, or relatively, such as the percentage of expenditures devoted to non-charitable activities)
- the non-compliance involves breaches of the Criminal Code (such as fraud or hate crime) or other quasi-criminal statutes
- the non-compliance involves breaches of the core requirements of the Income Tax Act (such as the requirement that an organization be established for exclusively charitable purposes, as compared to a less central provision, such as that requiring charities designated as charitable organizations to concentrate on operating their own programs, rather than funding other charities)
- the organization is not abiding by the terms of a compliance agreement

In cases of **aggravated** non-compliance, we will likely move directly to revoking the charity's registration.

These include cases where one or more of the following

factors are present:

- the organization has a previous record of serious non-compliance, and the current form of non-compliance is both serious and intentional
- the non-compliance has resulted in a substantial adverse impact on others (beneficiaries, donors, or funders), particularly where the organization cannot or will not remedy the harm done
- the organization cannot or will not bring itself into compliance

There are two other cases where we are likely to move directly to revocation. The first is when a charity does not file its annual return. The Directorate will continue its zero-tolerance policy for non-filers - if a charity does not file its return after we have reminded it to do so, we will simply revoke its registration. In our view, filing is a fundamental obligation for all registered charities. In its annual return, a charity accounts to donors and Canadians generally for its tax-advantaged status. The return also provides the Directorate with key information needed to administer and enforce the legislation. The

second are serious cases for which there is no appropriate sanction, such as engaging in non-charitable activities. However, we intend to exercise some discretion in these instances, as it is not our intention to move directly to revocation in those cases where it is possible and appropriate to work with the charity to get its operations back onside. It is our goal, in cases where the non-compliance is less severe, to work with charities through a compliance agreement as a first measure.

This describes our general approach. However, we know that exceptional circumstances arise, and we intend to allow for them. For example, we would be more likely to use a compliance agreement than a sanction for a case of serious non-compliance resulting from the unauthorized actions of a single employee, where the charity is ready to take steps to rectify the situation and prevent a recurrence. We also do not generally revoke a charity's registration if it is unable to file its return because of events beyond its control, such as a flood that destroyed its financial records.

Procedures

The decision whether to **educate** or use a **compliance agreement** is made by individual auditors across the CRA (Canada Revenue Agency). The auditor may discuss the matter with staff in the Charities Directorate and their subsequent decision requires the approval of their immediate supervisors. Auditors will then contact the charity to negotiate a compliance agreement or they will send the charity an educational letter.

Decisions about **sanctions other than revocation** are first discussed between the auditor and his or her supervisor, and with Charities Directorate staff. The charity is given a 30-day period in which it can make representations to the auditor as to why it should not be subject to a sanction. If we do not hear from the charity or do not accept its representations, the Charities Directorate will make the final decision whether to apply a sanction. The Director General of the Charities Directorate will notify the charity if a sanction is imposed. The affected charity then has 90 days in which it can choose to file a notice of objection. If the charity files a notice of objection, the matter is no longer in the hands of the Charities Directorate. The charity will deal directly

with the CRA (Canada Revenue Agency)'s Appeals Branch, and further recourse will lie with the Tax Court of Canada.

Decisions about **revoking a charity's registration** follow a similar path. Before any decision is made, Charities Directorate staff will first give a charity the opportunity to explain why the CRA (Canada Revenue Agency)'s views are incorrect or, if the charity agrees it has not been compliant, it may still wish to present reasons why its registration should not be revoked (for example, the non-compliance is being remedied). If the Directorate decides to revoke the charity's registration, the Director General (Charities Directorate) will notify the charity. As with other sanctions, the charity will generally then have 90 days to file a notice of objection, after which it will be dealing with the CRA (Canada Revenue Agency)'s Appeals Branch. Further recourse on revocation decisions will lie with the Federal Court of Appeal. In extreme cases of aggravated non-compliance, the CRA (Canada Revenue Agency) will proceed to revoke after 30 days unless the charity files a stay with the Federal Court of Appeal.

The sanctions

The Income Tax Act introduces two types of sanctions:

- financial penalties
- suspension of the charity's right to issue official donation receipts for one year

In most cases, the financial penalty will be the first sanction levied with charities generally being penalized more severely for repeat infractions. Repeat infraction means the charity has previously received a sanction involving the same type of non-compliance. For repeat infractions the penalty may be increased and, in some situations, the charity's receipting privileges may also be suspended.

It is important to note, however, certain infractions invoke the suspension of a charity's right to issue official donation receipts or to accept gifts from other registered charities for one year as a first measure.

Charities subject to one of these sanctions will have the following information made public on the Charities Directorate website:

- the name of the charity
- the particular sanction that is being applied (including the amount, as applicable)
- the effective date
- the reason for the sanction

Financial penalties above \$1,000 may be paid to another qualifying charity (an eligible donee), rather than to the Receiver General.

When a charity has been sanctioned it must fulfill certain obligations to avoid a more severe sanction. For instance, while under suspension, a charity is obliged to inform anyone (including other registered charities) planning to donate to it of its suspended status. It can still receive gifts, but it cannot issue an official donation receipt for them. We intend to revoke the registration of any suspended charity that issues an official donation receipt for a gift made to it during the suspension period. If the suspended charity arranges for another charity to receive and receipt gifts on its behalf, we intend to suspend the other charity as well.

A charity that receives a sanction has 90 days to file a notice of objection. Additionally, a charity that has received a suspension can apply to the Tax Court for a postponement. The Court can grant the postponement if it considers that it "would be just and equitable to do so."

The following paragraphs outline the specific legislative provisions. As we administer them, we expect to encounter varying fact situations and ambiguities in the wording of the provisions. At that point, we will need to develop more detailed policies to ensure consistent treatment. We will make these policies available on this website.

Sanctions are now provided for the following types of non-compliance.

Business activities

The penalty applies to a charitable organization or public foundation that carries on an unrelated business, and to a private foundation that carries on any business.

We would usually give a charity an opportunity to divest itself of the business, or unrelated business. Such cases would typically be the subject of a compliance agreement, with the sanction being applied only if the charity does not live up to the terms of the agreement.

For a first infraction, the penalty is 5% of the gross revenue from the business. For a repeat infraction, the penalty is 100% of the gross revenue, plus a year's suspension.

For more information, see [Policy Statement CPS-019, What is a related business?](#)

Control of a corporation (foundations only)

The penalty applies to a public or private foundation that acquires control over a corporation, unless the charity receives the controlling shares as a gift.

For more information, see [Summary Policy CSP-C28, Control of corporation.](#)

Usually, we would expect to enter into a compliance agreement with a charity before invoking this sanction, unless the infraction is serious.

For a first infraction, the penalty is 5% of the dividends the corporation pays to the charity in a year. For a repeat infraction, the penalty is 100% of the dividends.

Gifts to non-qualified donees

The penalty applies to a charity that makes a gift to a person ¹ who is not a qualified donee. (Qualified donees are the entities that can issue official donation receipts for the gifts they receive. The largest category is formed by other registered charities, but other categories include registered Canadian amateur athletic associations, municipalities, and the United Nations and its agencies.) Gifts made to individuals in the course of a charity's programs, such as a scholarship award, are not subject to this penalty.

Usually, we would expect to enter into a compliance agreement with a charity that makes a gift to a non-qualified donee, but if the infraction is serious we may

invoke this sanction or even revoke the organization's registration.

For a first infraction, the penalty is 105% of the amount gifted to a non-qualified donee. For a repeat infraction, the penalty is 110% of the amount.

Undue benefit

The penalty applies to a charity that confers an "undue benefit" on any of the following:

- a member of the charity or of its governing board
- a person who has contributed more than 50% of the charity's capital
- a person who is not **at arm's length** to a person:
 - who is a member of the charity or its governing board
 - who has contributed more than 50% of the charity's capital
- a person who is not at arm's length to the charity

The undue benefit does not necessarily have to come directly from the charity. It can also come from a third party if the charity instructs or allows the third party to redirect an amount that is legally payable to the charity.

A charity is **not** conferring an undue benefit if it makes reasonable payment for property or services it receives from one of the persons listed above. Thus, a member, who does work for a charity and is paid for it, is not receiving an undue benefit unless the amount paid is out of line with the usual rates for the work performed. Nor is it conferring an undue benefit if the person would be eligible for the benefit in the course of the ordinary operation of the charity's programs. For example, a hospital that sets the broken leg of a board member is not conferring an undue benefit on the member.

Usually, we would expect to enter into a compliance agreement with a charity before invoking this sanction, unless the infraction is serious.

For a first infraction, the penalty is 105% of the amount of the benefit. For a repeat infraction, the penalty is 110% of the amount, plus a year's suspension.

False information on official donation receipts

The penalty applies to a charity or anyone else that issues an official donation receipt that contains false information.

This is the extreme end of improperly issued donation receipts covering the cases where a receipt is deliberately falsified, perhaps as to the date when the gift was received but more frequently as to the amount of the gift (for example, inflated value of receipt with respect to actual value of gift). If the person responsible is an officer, employee, official, or agent of a charity, the charity is subject to the penalty. But the penalty also applies to people who:

- counterfeit the receipts of a legitimate charity
- issue false receipts on behalf of an organization that has no right to issue official donation receipts

In our experience, these cases typically form serious incidents of non-compliance. As a result, we anticipate that, faced with receipts containing false information, we

will not use compliance agreements, but rather proceed directly to imposing a sanction, which may include revoking the registration of any implicated charity.

For any infraction, the penalty is 125% of the eligible amount of the gift as it appears on any false receipt, plus a year's suspension if the total of all such penalties exceeds \$25,000. If by issuing false receipts, the person is also subject to a penalty under section 163.2 of the Income Tax Act (the section that provides for penalties for those who help or encourage others to make false claims on their tax returns, usually as part of a tax-shelter promotion),² the person is subject to whichever penalty is larger.

Incorrect information on official donation receipts

The penalty applies to a charity that issues an official donation receipt that contains incorrect information.

This sanction targets all other errors on a receipt not amounting to false information. Incorrect information includes omitting information that should be on the

receipt (for example, not including the CRA (Canada Revenue Agency)'s website address). The information that should be on official donation receipts is listed in Sample official donation receipts.

Generally, we would anticipate using compliance agreements before proceeding to one of the sanctions unless the infraction is serious.

For any infraction, the penalty is 5% of the eligible amount of the gift as it appears on any incorrect receipt, or 10% for a repeat infraction.

Inadequate books and records

The penalty applies to a charity that does not maintain adequate books and records. It also applies to a charity that does not give an auditor access to its books and records or does not allow the auditor to copy them.

Information about books and records can be found in Books and records.

Inadequate books and records can range from minor oversights on the part of the charity, to very serious infractions including records that are deliberately altered, destroyed, hidden, or not collected in order to conceal non-compliance. While we will generally use compliance agreements first, in cases of serious non-compliance we will likely move directly to a sanction, and possibly even revocation of the charity's registration.

The sanction for any books and records infraction is a year's suspension.

Inter-charity gifting to delay expenditures

The penalty applies to charities that exchange gifts as a way to delay expenditures required to meet their disbursement quota.

Example

Two charities each have a disbursement quota of \$10,000. Charity A writes a \$10,000 cheque to Charity B, and Charity B writes an equivalent cheque to Charity A. Both claim to have met their disbursement quota on the basis of a \$10,000 gift to a qualified donee, but in reality neither charity has made any expenditure.

In this type of abusive inter-charity gifting, we anticipate most cases will qualify as serious forms of non-compliance, and we would proceed directly to applying the sanction.

Both charities involved are subject to a penalty equal to 110% of the amount exchanged. Usually, we would ask Charity A and Charity B each to pay half the penalty, but we have the discretion to assess the full penalty against either of them.

Not filing the annual return

The penalty applies to charities that do not file their annual return on time.

The legislation allows for a \$500 penalty for failure to file the return on time. However, we intend, for the present, to apply this penalty only to charities that:

- have had their registration revoked for not filing the annual return
- apply for re-registration

Organizations in this situation have to act quickly to avoid the revocation tax that the Act imposes on charities if they lose their registration. ³ Within 12 months of the time we send the notice that we intend to revoke their registration, they will have to do all of the following:

- rectify their filing deficiency
- pay any outstanding penalties (including the \$500 non-filing penalty), taxes, and interest under the Income Tax Act and the Excise Tax Act
- obtain re-registration

One of the first things we will check in an application for re-registration is whether a cheque for the \$500 has been enclosed.

Conclusion

The Charities Directorate has a responsibility to ensure that registered charities comply with their legal requirements under the Income Tax Act. We prefer to do this through educating charities about the rules and working with them to sort out any problems that arise.

However, organizations that deliberately flout the law, or ignore their agreements with us, are telling us that stronger measures are necessary. Accordingly, the CRA (Canada Revenue Agency) will use one of the sanctions or revoke a registration if and when required.

Footnotes

Footnote 1

Note that, in the Income Tax Act, "person" means not just individuals but entities like companies and

partnerships. As noted previously, charities under suspension are not qualified donees.

Footnote 2

For more information on section 163.2, see [Information Circular IC01-1, Third-Party Civil Penalties](#).

Footnote 3

The revocation tax is not new. For more on re-registration and the revocation tax, see [Guide RC4424, Completing the Tax Return Where Registration of a Charity is Revoked](#).

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