



CANADA REVENUE  
AGENCY

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DU CANADA

**REGISTERED MAIL**

Children's Emergency Foundation  
2243 Queen Street East, Second Floor  
Toronto ON M4E 1G1

BN: 890473564

Attention: Ms. Mary Lynne Stewart

File #:1094721

May 11, 2009

**Subject:      Revocation of Registration**  
**Children's Emergency Foundation**

Dear Ms. Stewart:

The purpose of this letter is to inform you that a notice revoking the registration of Children's Emergency Foundation (the Organization) was published in the *Canada Gazette* on May 9, 2009. Effective on that date, the Organization ceased to be a registered charity.

**Consequences of Revocation:**

- a) The Organization is no longer exempt from Part I Tax as a registered charity and **is no longer permitted to issue official donation receipts**. This means that gifts made to the Organization are no longer allowable as tax credits to individual donors or as allowable deductions to corporate donors under subsection 118.1(3), or paragraph 110.1(1)(a), of the *Income Tax Act* (the Act), respectively.
- b) By virtue of section 188 of the Act, the Organization will be required to pay a tax within one year from the date of the Notice of Intention to Revoke. This revocation tax is calculated on prescribed form T-2046 "*Tax Return Where Registration of a Charity is Revoked*" (the Return). The Return must be filed, and the tax paid, on or before the day that is one year from the date of the Notice of Intention to Revoke. A copy of the Return is enclosed. The related Guide RC-4424, "*Completing the Tax Return Where Registration of a Charity is Revoked*", is available on our website at [www.cra-arc.gc.ca/E/pub/tq/rc4424](http://www.cra-arc.gc.ca/E/pub/tq/rc4424).

Section 188(2) of the Act stipulates that a person (other than a qualified donee) who receives an amount from the Organization is jointly and severally liable with the Organization for the tax payable under section 188 of the Act by the Organization.

- c) The Organization no longer qualifies as a charity for purposes of subsection 123(1) of the *Excise Tax Act* (ETA). As a result, the Organization may be subject to obligations and entitlements under the ETA that apply to organizations other than charities. If you have any questions about your GST/HST obligations and entitlements, please call GST/HST Rulings at 1-888-830-7747 (Quebec) or 1-800-959-8287 (rest of Canada).

In accordance with *Income Tax Regulation* 5800, the Organization is required to retain its books and records, including duplicate official donation receipts, for a minimum of two years after the Organization's effective date of revocation.

Finally, we wish to advise that subsection 150(1) of the Act requires that every corporation (other than a corporation that was a registered charity throughout the year) file a *Return of Income* with the Minister of National Revenue (the Minister) in prescribed form, containing prescribed information, for each taxation year. The *Return of Income* must be filed without notice or demand.

If you have any questions or require further information or clarification, please do not hesitate to contact the undersigned at the numbers indicated below.

Yours sincerely,



Danie Huppé-Cranford  
Director  
Compliance Division  
Charities Directorate  
Telephone: 613-957-8682  
Toll free: 1-800-267-2384

Enclosures

- Copy of the Return (form T-2046)
- Canada Gazette publication

Cc: Karen J. Cooper, Carters Professional Corporation  
70 Gloucester Street, Ottawa ON K2P 0A2



**REGISTERED MAIL**

The Children's Emergency Foundation  
2243 Queen Street East, Second Floor  
Toronto ON M4E 1G1

**MAR 27 2009**

**Attention: Ms. Mary Lynne Stewart, President**

BN: 89047 3564RR0001

File #: 1094721

**Subject:     **Notice of Intention to Revoke**  
                  **The Children's Emergency Foundation****

Dear Ms. Stewart:

I am writing further to our letter dated July 15, 2008 (copy enclosed), in which you were invited to submit representations as to why the Minister of National Revenue (the Minister) should not revoke the registration of The Children's Emergency Foundation (the Charity) in accordance with subsection 168(1) of the *Income Tax Act* (the Act).

We have now reviewed and considered the written response dated October 2, 2008 (copy enclosed) from your authorized representative, Ms. Karen Cooper of Carters Professional Corporation. However, notwithstanding your reply, our concerns with respect to the Charity's non-compliance with the requirements of the Act for registration as a charity have not been alleviated. Our position is fully described in Appendix "A" attached.

**Conclusion:**

Our audit revealed that the Charity has devoted a significant portion of its resources to the promotion of two tax shelter donation arrangements, an international donation arrangement and has devoted a substantial portion of its actual cash donations to fundraising and administrative expenses. It is our position the Charity failed to maintain adequate documentation to support the receipt and distribution of non-cash property overseas; failed to meet its annual disbursement quota; issued official donation receipts otherwise than in compliance with the Act; filed inaccurate Registered Charity Information Returns including incomplete financial statements in each of the fiscal periods ending 2002 to 2005; and failed to prepare and file T4/T4A Statements of Remuneration payments to persons the Charity deems independent contractors.

The Charity reported receiving cash and non-cash gifts totalling in excess of \$57.8 million from donors and charities during the periods audited. Of this amount, \$46.7 million consisted of non-cash gifts received from donors and charities participating in the tax shelters and international donation arrangements. The Charity reported distributing these non-cash gifts as part of its own activities. However, the Charity's records fail to substantiate the values represented, whether the property was ever in the Charity's possession, that the property was distributed or even if the property actually existed.

The remaining \$11.1 million was received as tax-receipted cash donations. Of this amount, the Charity directed \$7.9 million to fundraising and administrative fees, while devoting only \$3.2 million to its own charitable activities. Based on the amounts devoted by the Charity to activities that do not promote or advance its own charitable purposes, it is our position that the Charity devotes a preponderance of its resources to furthering non-charitable activities. For all of these reasons, and for each of these reasons alone, it is the position of the Canada Revenue Agency (CRA) that the Charity's registration should be revoked.

Consequently, for each of the reasons mentioned in our letter dated July 15, 2008, I wish to advise you that, pursuant to the authority granted to the Minister in subsections 149.1(2) and 168(1) of the Act, which has been delegated to me, I propose to revoke the registration of the Charity. By virtue of subsection 168(2) of the Act, revocation will be effective on the date of publication of the following notice in the *Canada Gazette*:

*Notice is hereby given, pursuant to paragraphs 168(1)(b), 168(1)(c), 168(1)(d) and 168(1)(e) of the Income Tax Act, that I propose to revoke the registration of the organization listed below under subsection 149.1(2) of the Income Tax Act and that the revocation of registration is effective on the date of publication of this notice.*

<b>Business Number</b>	<b>Name</b>
89047 3564 RR 0001	The Children's Emergency Foundation Toronto, ON

Should you wish to object to this Notice of Intention to Revoke the Charity's registration in accordance with subsection 168(4) of the Act, a written Notice of Objection, which includes the reasons for objection and all relevant facts, must be filed within **90 days** from the day this letter was mailed. The Notice of Objection should be sent to:

Tax and Charities Appeals Directorate  
Appeals Branch  
Canada Revenue Agency  
25 Nicholas Street  
Ottawa ON K1A 0L5

A copy of the revocation notice, described above, will be published in the *Canada Gazette* after the expiration of 30 days from the date this letter was mailed. The Charity's registration will be revoked on the date of publication, unless the CRA receives an order, **within the next 30 days**, from the Federal Court of Appeal issued under paragraph 168(2)(b) of the Act extending that period.

Please note that the Charity must obtain an order from the Federal Court of Appeal to suspend the revocation process, notwithstanding the fact that it may have filed a Notice of Objection.

### **Consequences of Revocation:**

As of the effective date of revocation:

- a) the Charity will no longer be exempt from Part I Tax as a registered charity and **will no longer be permitted to issue official donation receipts**. This means that gifts made to the Charity would not be allowable as tax credits to individual donors or as allowable deductions to corporate donors under subsection 118.1(3), or paragraph 110.1(1)(a), of the Act, respectively;
- b) by virtue of section 188 of the Act, the Charity will be required to pay a tax within one year from the date of the Notice of Intention to Revoke. This revocation tax is calculated on prescribed form T-2046 "*Tax Return Where Registration of a Charity is Revoked*" (the Return). The Return must be filed, and the tax paid, on or before the day that is one year from the date of the Notice of Intention to Revoke. A copy of the relevant provisions of the Act concerning revocation of registration, the tax applicable to revoked charities, and appeals against revocation, can be found in Appendix "A", attached. Form T-2046, and the related Guide RC-4424, "*Completing the Tax Return Where Registration of a Charity is Revoked*", are available on our website at [www.cra-arc.gc.ca/charities](http://www.cra-arc.gc.ca/charities);
- c) the Charity will no longer qualify as a charity for purposes of subsection 123(1) of the *Excise Tax Act* (ETA). As a result, the Charity may be subject to obligations and entitlements under the ETA that apply to organizations other than charities. If you have any questions about your GST/HST obligations and entitlements, please call GST/HST Rulings at 1-888-830-7747 (Quebec) or 1-800-959-8287 (rest of Canada).

Finally, I wish to advise that subsection 150(1) of the Act requires that every corporation (other than a corporation that was a registered charity throughout the year) file a *Return of Income* with the Minister in prescribed form, containing prescribed information, for each taxation year. The *Return of Income* must be filed without notice or demand thereof.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Terry de March', written in a cursive style.

Terry de March  
Director General  
Charities Directorate

Attachments:

- CRA letter dated July 15, 2008;
- Your letter dated October 2, 2008;
- Appendix "A", Comments on Representations of October 2, 2008; and
- Appendix "B", Relevant provisions of the Act

Cc: Karen J. Cooper, Carters Professional Corporation  
70 Gloucester Street, Ottawa ON K2P 0A2

THE CHILDREN'S EMERGENCY FOUNDATION

**COMMENTS ON REPRESENTATIONS OF OCTOBER 2, 2008**

The audit conducted by the Canada Revenue Agency (the CRA), identified that The Children's Emergency Foundation (the Charity), based on the activities of the Charity and the level of financial activity and resources devoted, is not devoting its resources to entirely charitable purposes. In our view, the Charity's original purpose, which is to provide relief to children and their families, and to educate the Canadian public concerning the needs of such children and families, has been sidetracked by its participation in two tax shelter gifting arrangements, an international donation arrangement and third party fundraising with residual funds devoted to its registered charitable purpose.

The CRA's audit has concluded that from January 1, 2002 to December 31, 2005, the Charity issued official donation receipts in excess of \$29.9 million and received nearly \$27.9 million in gifts from other charities. During this same period, the Charity reported receiving and distributing non-cash gifts of pharmaceuticals, pure powdered barley grass and long grained white rice of \$31.3 million from participants in the two tax shelter gifting arrangements in addition to \$15.4 million allegedly received from charities involved in an international donation arrangement. Of the \$11.1 million received in tax-receipted cash donations, the Charity paid \$5.6 to third party fundraisers, \$2.3 for management and administrative expenses while devoting \$3.2 million to its own charitable activities such as feeding programs.<sup>1</sup> Based on the amounts devoted by the Charity to its involvement in activities that do not promote or advance the Charity's own charitable purposes, it is our position the Charity devotes a preponderance of its resources to furthering non-charitable activities.

**Tax Shelter Gifting Arrangements:**

*Per our July 15, 2008 letter, the Charity participated in the Canadian Gift Initiatives (CGI) and Canadian Hunger Relief Program (CHRP) by agreeing to accept and distribute non-cash property donated to the Charity by participants. It is CRA's position, as discussed in our previous letter that the Charity simply operated as a conduit for the tax shelters in return for a commission.*

The representations of October 2, 2008 deny the Charity participated in two tax shelter donation arrangements as the representations state the Charity "*participated in one program, the one operated by CGI [Canadian Gift Initiatives]. The Charity played no role in the donation tax planning program undertaken by [The] Change Canada [Foundation] other than to facilitate the shipping and distribution of food...*" CRA disagrees with the Charity's categorization of their involvement and role in the CHRP.

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<sup>1</sup> Referencing the 2006 and 2007 figures, as reported on the annual information returns filed by the Charity, total-tax receipted donations of over \$5.7 million and total other gifts (including gifts from other charities) of over \$5.6 million have been received. The Charity allegedly received and distributed an additional \$5.6 million in non-cash goods related to the international donation arrangement, incurred \$2.9 million in fundraising expenses and \$1.1 million in management and administrative costs with \$1.7 million devoted to the Charity's own programs.

With respect to the CGI tax shelter, which the Charity admits to participating in, 87% of the Charity's reported income in 2003 was received through this arrangement. As detailed in our previous letter, the Charity issued receipts totalling in excess of \$18 million, as instructed, and received a 0.5% fee from CGI based on the purported value of the donations received. The Charity was not responsible for determining the fair market value of the pharmaceuticals, did not take physical delivery of the goods, nor was it responsible for or involved in the distribution of these goods.

We accept your submission that the Charity's role in the CGI program was largely limited to "*receiving the information required to process the donations, and processing the donations.*" This, of course, does not change the fact that the Charity has structured its affairs such that it purportedly receives and distributes property whereupon the overwhelming majority of its income and expenditures during this period is with respect to this property. In this respect, we conclude that the preponderance of the Charity's financial and physical resources during this period have been devoted to promoting this tax shelter arrangement which is not a charitable purpose at law. That the Charity's active participation was limited to receiving the information required to process the donations which flow through it only adds to the conclusion that the Charity is merely paid to issue receipts and to act as a conduit for this arrangement.

Similarly, with respect to the CHRP, the Charity received 83% of its income in 2004 from The Change Canada Foundation. It is our position the Charity's role was not simply to arrange the shipment of the food. Indeed, *per* our previous letter, the Charity's records pertaining to the shipping and distribution of the food indicate the tax shelter made all arrangements without any involvement by the Charity. The Charity's role was to receive the property (although the Charity neither inspected nor took physical delivery of the goods), and report the equivalent value as having been distributed. The Charity neither inspected nor established whether the value provided was the foods true fair market value. Based on the records provided, the Charity merely signed the agreements presented by the tax shelter promoter in exchange for \$19,000<sup>2</sup>. The Charity was not even responsible for determining the ultimate distribution of the property. It is our conclusion that the Charity's role in this program was that of a conduit, paid a small fee to give the appearance that it distributed in excess of \$12 million in property.

Accordingly, it remains our position that the Charity has willingly lent its name, tax receipting privileges and qualified donee status to the CGI and CHRP tax shelter programs in exchange for monetary compensation and has participated in programs designed to abuse the charitable gift incentive provisions of the *Income Tax Act* (the Act). Accordingly, it is our position the Charity has operated for the non-charitable purpose of promoting and participating in tax shelter arrangements and, therefore cannot be considered to be a charitable foundation *operated exclusively for charitable purposes*.

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<sup>2</sup> Charity received "gift" of \$118,750 from The Change Canada Foundation and paid \$99,750 to Global Relief Fund for shipping costs.



Under paragraph 168(1)(b) of the Act, the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration because it ceases to comply with the requirements of the Act related to its registration as such. It is our position that The Children's Emergency Foundation has not operated for exclusively charitable purposes. For this reason alone there are grounds to revoke the charitable status of The Children's Emergency Foundation.

### **International Donation Arrangement and Foreign Activities:**

As described in our previous letter, our audit revealed that the Charity does not maintain the requisite level of direction and control for all goods it purportedly distributes internationally. In addition to the goods received by the Charity through its participation in the two registered tax shelters, the Charity also reported an additional \$15.4 million in "gifts" received from International Aid (IA) or Universal Aide Society (UAS). The Charity reports these "gifts" as their own activities but has not provided confirmation the goods existed in the quantities and values recorded by IA and UAS, and that the goods were distributed to international organizations of the Charity's own evaluation and selection. CRA audits have determined that the Charity simply pays the shipping costs associated with transferring the goods from their source to the pre-determined recipient organization and that at no time, are the goods physically received, inspected or verified by the Charity or its agents.

In its reply, the Charity cites CRA policies with respect to the distribution of goods outside of the country. While we acknowledge that the CRA accepts that certain goods by their very nature can only be used for charitable activities, as described in further detail below, this does not relieve an organization of all responsibilities. A registered charity must be able to demonstrate that it was responsible for the charitable activity itself, that the charitable activity actually occurred and occurred on the scale represented. It is simply not sufficient to state that millions of dollars in relief activities occurred, claiming these as charitable expenditures against the organization's disbursement quota, without sufficient proof as to values, volumes, destinations or ultimate use. Absent such documentation the CRA has no means of determining whether the goods exist, testing what the value of the goods shipped were, or even whether the goods were, in fact, distributed for charitable activities or instead sold, disposed of or sit unused.

*Per* our previous letter, it is CRA's position the Charity participates in this international donation arrangement to artificially inflate its expenditures on charitable activities and to meet its annual disbursement quota with minimal actual cash outlay. The Charity reports the "gifts" received from IA and UAS as both income and expenses against its disbursement quota. Outside of this activity, the Charity devotes a substantial amount of its tax-receipted cash donations (excluding tax shelter donations) to non-charitable activities such as fundraising, commodity acquisition and administration, and without the donations of non-cash property, the Charity would find it difficult to meet its annual disbursement quota. As reported above, the Charity received \$11.1 million in cash donations yet devoted \$8.9 million or 80% of cash donations to fundraising and

administrative costs with \$3.2 million or 20% spent on charitable programs. In our view, the Charity participates in this international donation arrangement to artificially offset the disproportionate expenditures on non-qualifying expenses for disbursement quota purposes.

*Direction and Control*

The case law supports the position that the existence of an agency agreement alone is not sufficient - in order for an organization to show that it exercises sufficient direction and control over its resources and activities, it must evidence that it effectively implements and enforces the agreement, which the Charity was clearly unable to do.

In *The Canadian Committee for the Tel Aviv Foundation vs. Her Majesty the Queen*,<sup>3</sup> the organization under review had an agency agreement in place, but was unable to produce sufficient documentary evidence to demonstrate that the agreement was enforced and adhered to. The Canadian Federal Court of Appeal (FCA) upheld the Minister's decision to revoke the organization, based, in part, on the following areas of non-compliance:

"Under the scheme of the [*Income Tax Act*], it is open to a charity to conduct its overseas activities either using its own personnel or through an agent. However, it cannot merely be a conduit to funnel donations overseas. In this case, the Agency Agreement was ignored by the Committee, and the Minister was not satisfied that the Committee's explanations of its conduct overseas were sufficient to overcome his conclusion that the Committee had no direction and control over how funds were spent by its agent. The evidence that was provided would suggest that the Committee was merely acting as a conduit for Canadian donors to overseas donees. For example, the evidence discloses that the Committee sent the majority of the funds it raised to its agent in Israel, but provided little documentary evidence of the Committee's control over how those funds were spent." (paragraph 30)

And,

"While a charity may carry on its charitable activities through an agent, the charity must be prepared to satisfy the Minister that it is at all times both in control of its agent, and in a position to report on the agent's activities. In this case, the Minister's main reasons for revocation are that the Committee could not demonstrate, through documentary evidence, that it exercised a sufficient degree of control over the use of its funds by its agent in Tel Aviv and the Committee did not keep proper books and records of activities carried on by its agent. Even though the Minister's reasons are couched in terms of non-compliance with the Agency Agreement, the requirements under the latter are, in my view, simply a means of ensuring compliance with the [*Income Tax Act*]" (paragraph 40)

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<sup>3</sup> [2002] FCA 72

In the case of *Bayit Lepletot*<sup>4</sup>, the FCA reiterated that a charity which operates via an agent must be in a position to show that its agent is actually carrying out the activities in question *on its [the Charity's] behalf*.

"It is open for [a charity] to carry on its charitable works through an agent but it must be shown that the agent is actually carrying on the charitable works. It is not sufficient to show that the agent is part of another charitable organization which carries on a charitable program. The question which remains in such a case, as it does here, is who is carrying on the charitable works. It was incumbent upon the appellant to show that they were being carried on its behalf. On the record before us it was open to the Minister to conclude that it had failed to do so." (paragraph 5)

As such, the existence of an agency relationship and agreement does not suffice. Evidence demonstrating that the agent acted in accordance with the terms of the arrangement, under the charity's continuous instruction and supervision, is also necessary. In the case of the Charity, it has not provided a sufficient basis, by way of documentary evidence, to support its contention that the activities carried on by its purported agent were, in fact, its own.

Further support for this position is found in the case of *Canadian Magen David Adom for Israel v. Minister of National Revenue*<sup>5</sup>:

"[A] charitable organization is obliged to carry on its charitable activities itself. If it does not do so, its registration may be revoked. A charitable organization that wishes to operate in a location where it has no officers or employees must somehow act through a person in that location. That could obviously be done by establishing an agency relationship between the charity and the person. Evidence that such a relationship has been established by contract, and that the contract has been adhered to, might well be the most straightforward means of proving to the Minister that a person purporting to carry out the charitable activities of a charity in a particular location is in fact acting on behalf of the charity. It is possible that the same result might be achieved by other means. *However, a charity that chooses to carry out its activities in a foreign country through an agent or otherwise must be in a position to establish that any acts that purport to be those of the charity are effectively authorized, controlled and monitored by the charity.*" (emphasis added).

The Charity submits that its books and records demonstrate evidence of control and supervision, in addition to maintaining appropriate agency agreements. This submission contradicts the information provided during the course of the audit. The Charity notes it engaged the services of Brian Nelson, operating as BNS, to supervise many of its activities abroad however our audit found Mr. Nelson's contract with the Charity expired as of September 30, 1999 and the Charity confirmed it does not have any contracts with Mr. Nelson beyond this date. Regardless if the contract renewal was an

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<sup>4</sup> *Bayit Lepletot v. Minister of National Revenue*, [2006] FCA 128

<sup>5</sup> [2002] FCA 323, at paragraph 66

oversight on the Charity's part, the audit also revealed the Charity's Board of Director minutes do not discuss the involvement of Mr. Nelson in overseas programs beyond 2003 and was only able to provide copies of three written reports submitted by Mr. Nelson; the last of which was September 15, 2003. As we stated in our earlier letter, the Charity does not have agency agreements with IA or UAS nor does the Charity maintain records to demonstrate its active control and supervision over the activities undertaken by IA or UAS, or other independent agents, on the Charity's behalf.

Per the Charity's submission, it *"specifically [relies] on CRA policy that where the charitable activities of an organization involve the transfer of goods outside the country, CRA will consider the transfer of property in this manner to be reasonable where the nature of the property can only be used for a charitable purpose."* The Charity further contends *"[p]articularly the medicines and nutritional supplements, by their very nature, can only be used for the treatment of medical illnesses and fall squarely with CRA's policy which allows a transfer of property to a non-qualified donee without the necessity of a structured and formal arrangement."*

Again, while the CRA acknowledges this slight relaxing of its strict requirements in certain circumstances, a charity must nonetheless be able to support the use of property purportedly received and distributed by it and the relating amounts reported as charitable expenditures. In the case of the Charity, there is no evidence in support of the status and activities of the recipient, or that the donated goods were used for charitable purposes or formed part of the Charity's own activities. A charity cannot simply forgo its responsibilities and diligence simply because of the nature of goods being distributed. In our view, the Charity has not demonstrated that it maintained control over its resources, nor can it demonstrate the ultimate use and distribution of the goods by its agents, such that it can claim it distributed at least \$15.4 million of goods on charitable activities carried on by it. In fact, it is our view that the Charity simply pays for shipping costs assuming that charitable goods are distributed such that it can claim the related expenditure.

For these reasons, and those set out in our letter of July 15, 2008, we continue to be of the view that the Charity is not devoting substantially all of its resources to its own charitable activities. Under paragraph 168(1)(b) of the Act, the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration because it ceases to comply with the requirements of the Act related to its registration as such. It is our position that The Children's Emergency Foundation has not demonstrated that it devoted all of its resources to charitable activities carried on by it. For this reason alone there are grounds to revoke the charitable status of The Children's Emergency Foundation.

### **Fundraising:**

We accept the Charity's concurrence that all amounts paid to professional fundraising companies are considered fundraising expenses and cannot be considered charitable. In this regard, the Charity should not have reduced total fundraising expenses

reported on the T3010 by 20% and reported this reduction internally as "Public Education and Advocacy" expenses. As outlined in section 5 of our July 15, 2008 letter, the Charity has reduced total fundraising and total operating expenses by nearly \$1 million over the four year audit period.

However, as indicated above it remains our view that the Charity has not sufficiently established that it received or distributed the property it received through the tax shelter arrangements and other programs, nor are we satisfied the fair market value of these goods has been properly established. *Per* our previous letter, we are therefore not prepared to recognize the amounts reported as commodity distributions, tax shelter distributions or otherwise, as expenditures by the Charity on its own charitable activities.

It remains our view that the Charity has only sufficiently demonstrated its active involvement and expenditures associated with its meal programs. Even looking at this limited sphere of activity the Charity is clearly not devoting all of its resources to charitable activities carried on by it. As per to our previous letter the audit of the Charity has revealed that of the \$8.2 million received through third-party fundraising, 55% is paid to the fundraisers. Only \$1.9 million (23%) finds its way to the meal programs. In our view this is insufficient to demonstrate that the Charity devotes all of its resources to charitable activity when the vast majority of the amounts received are devoted to fundraising and administration. As above, it remains our view that the primary purpose of the Charity's involvement in the international donation arrangements is to assist it in artificially correcting this deficiency.

For this reason, and those set out in our letter of July 15, 2008, we continue to be of the view that the Charity is not devoting all of its resources to charitable activities. Under paragraph 168(1)(b) of the Act, the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration because it ceases to comply with the requirements of the Act related to its registration as such. It is our position that The Children's Emergency Foundation has not devoted all of its resources to charitable activities carried on by the organization itself. For this reason alone there are grounds to revoke the charitable status of The Children's Emergency Foundation.

**Receipting:**

The Charity maintains that the amount reported on the official donation receipts issued to acknowledge pharmaceuticals received as part of its participation in the CGI tax shelter was equal to the fair market value of the goods at the time of gift as the amounts were based primarily on prices paid in arm's length transactions in Canada (i.e. amounts paid for single unit purchases in Canada). It remains the CRA's position that the actual fair market value of the pharmaceuticals donated to the Charity is the actual supplier's cost of the pharmaceuticals. Again, in our view this position is supported by the case law on the subject as referenced in our previous letter. However, as the Charity has requested this information, we are providing you copies of each of the reports referenced in our previous

letter. You are correct that the tax receipting issue relates solely to that under the Canadian Hunger Relief Program. However, we are nonetheless providing you copies of both reports as it is relevant to the amounts relating to expenditures purportedly made towards the Charity's programs described above.

The Charity expressly denies that it failed to exercise an appropriate degree of due diligence but has failed to demonstrate to or convince the CRA of the due diligence undertaken. As explained in our July 15, 2008 letter, the Charity supplied binders of documentation supporting its participation in the CGI program which included professional opinions provided to Canadian Gift Initiatives Corporation, the tax shelter promoter, and Escarpment Biosphere Foundation, another participating charity; absent were any professional opinion provided to the Charity. We reiterate that the donation receipts issued by the Charity, on average, were 5-6 times the donor's purchase price for pharmaceuticals.

The representations of October 2, 2008 do not address our findings related to donations received for the Charity's Zim Project. As we outline in our July 15, 2008 letter, the Charity failed to deduct the amount of the advantage received by donors from the tax-receipted membership fees and the Charity issued receipts for donations directed to specifically named individuals. Our position remains that the Charity was required by the Act to reduce the amount recorded on the official donation receipt by the advantage and should not have acknowledged directed donations with official donation receipts.

Under paragraphs 168(1)(d), the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration if it issues a receipt otherwise than in accordance with the Act and the Regulations. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

#### **Disbursement Quota:**

The Charity maintains that its expenditures on programs outside Canada are charitable expenditures despite a lack of evidence to demonstrate that the Charity actually received goods, how values were established, any control and direction over the use of the goods or how goods were ultimately distributed. It remains our position that amounts reported by the Charity as distributions of pharmaceuticals, powdered barley grass and rice were not programs carried by the Charity and were not reflective of the good's factual fair market value; and, given the insufficient documentation, we are not prepared to recognize the amounts reported as commodity acquisition and distribution (i.e. sponsorship payments to and "gifts" received from IA and UAS) as being expenditures on charitable activities carried on by the organization itself or in the amounts reported. Any amounts recorded by the Charity as education and advocacy expenses do not affect the disbursement quota. As above, the Charity failed to report the 20% reduction in fundraising expenses on the T3010's filed and were therefore not included as a charitable expense for disbursement quota purposes.

As described in our previous letter, we remain of the view that the Charity is in a significant shortfall position. Under paragraph 168(1)(d) of the Act, the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration because it ceases to comply with the requirements of the Act related to its registration as such. It remains the CRA's the Charity failed to meet its annual disbursement quota and has a disbursement quota shortfall exceeding \$20 million. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

**Other Issues:**

Our position remains unchanged to the remaining areas of non-compliance identified in our July 15, 2008 letter. No further information has been provided by the Charity and the representations submitted do not alter our findings. It is our position the Charity filed an inaccurate Registered Charity Information Return, form T3010 in each of the fiscal periods ending 2002 to 2005; failed to prepare and file T4/T4A Statements of Remuneration payments to persons the Charity deems independent contractors; failed to maintain adequate documentation to support the receipt and distribution of non-cash property overseas; and filed inaccurate financial statements due to a failure to record all transactions recorded in the Charity's bookkeeping records (i.e. general ledger).

The representations indicate the discrepancies identified in the Charity's records *"concern the allocation of certain expenses and do not identify any substantive failure"*. We refer you to Appendix "C" of our July 15, 2008 letter which summarizes the amounts reported by the Charity in its general ledger, financial statements and T3010. Appendix "C" reveals the income and expenses the Charity failed to report on the T3010's filed. In our view the omissions of the Charity, representing hundreds of thousands or millions of dollars in income and expenditures, are significant.

**Appropriateness of Revocation:**

Finally, we note that your letter states the Charity, *"is prepared to take any remedial action required...in the interest of avoiding revocation of its charitable registration..."* and that it *"has completely ceased its involvement with donation tax planning structures."* In our view the non-compliance described herein is too serious to consider the continued registration of the Charity. In our view, the Charity has operated for the non-charitable purpose of promoting tax shelter arrangements, failed to exercise control over the resources obtained through these arrangements, and has improperly issued overvalued receipts for in excess of \$18.8 million in transactions.

While we recognize the Charity has ceased its participation in tax shelter donation arrangements, the Charity continues to participate in the international donation program whereby the Charity reports receiving and distributing millions of dollars of non-cash property from other registered charities but in fact, cannot substantiate the values reported, or the receipt and distribution of this property. Further, even viewing the

Charity's limited activities which are within its direct control and supervision, we are of the view that the direct expenditures on charitable activities are grossly overshadowed by the expenditures on fundraising and administration. As such, it is the CRA's position that these are serious contraventions of the *Income Tax Act* and warrant revocation of the Charity's registered status.





**REGISTERED MAIL**

The Children's Emergency Foundation  
2243 Queen Street East, Second Floor  
Toronto, ON M4E 1G1

BN: 89047 3564RR0001  
File #: 1094721

Attention: Ms. Jill McKinney, Executive Director

July 15, 2008

Dear Ms. McKinney:

**RE: Audit of The Children's Emergency Foundation**

This letter is further to the audit of the books and records of The Children's Emergency Foundation (the "Charity") by the Canada Revenue Agency (the "CRA"). The audit related to the operations of the registered charity for the period from January 1, 2002 to December 31, 2005.

The results of this audit indicate that the Charity appears to be in non-compliance of certain provisions of the *Income Tax Act* (the "ITA") or its Regulations. The CRA has identified specific areas of non-compliance with the provisions of the ITA or its Regulations in the following areas:

<b>AREAS OF NON-COMPLIANCE:</b>		
	<b>Issue</b>	<b>Reference</b>
1.	Failure to Devote Resources to Charitable Activities	149.1(2), 149.1(4.1), 168(1)(b), 168(1)(d)
2.	Failure to Accept Valid Gifts	118.1
3.	Failure to Issue Receipts in Accordance with the ITA	Regulation 3501, 149.1(2), 168(1)(d)
4.	Failure to Meet Disbursement Quota	149.1(2)(b), 168(1)(d)
5.	Failure to File an Accurate Registered Charity Information Return ("T3010"):	149.1(2), 168(1)(c)
6.	Failure to Prepare T4/T4A Documentation for Payments to Employee	149.1(2), 168(1)(c)
7.	Failure to Maintain Adequate Books and Records	149.1(2), 168(1)(e), 230 (2)

The purpose of this letter is to describe the areas of non-compliance identified by the CRA during the course of our audit as they relate to the legislative provisions

Canada Revenue Agency  
Charities Directorate – Compliance Division  
320 Queen Street, 7<sup>th</sup> Floor  
Ottawa, ON K1A 0L5

applicable to registered charities and to provide the Charity with the opportunity to address our concerns. In order for a registered charity to retain its registration, it is required to comply with the provisions of the ITA and Common Law applicable to registered charities. If these provisions are not complied with, the Minister of National Revenue may revoke the Charity's registration in the manner prescribed in section 168 of the ITA.

The balance of this letter describes the areas of non-compliance in further detail.

### **Identified Areas of Non-Compliance:**

#### **1. Failure to Devote Resources to Charitable Activities**

The Charity is registered as a charitable organization. In order to satisfy the definition of a "charitable organization" pursuant to subsection 149.1(1) of the ITA, "charitable organization" means an organization.... "All the resources of which are devoted to charitable activities".

To qualify for registration as a charity under the ITA, an organization must be established for charitable purposes that oblige it to devote all its resources to its own charitable activities. This is a two-part test. First, the purposes it pursues must be wholly charitable and second, the activities that a charity undertakes on a day-to-day basis must support its charitable purposes in a manner consistent with charitable law. Charitable purposes are not defined in the ITA and it is therefore necessary to refer, in this respect, to the principles of the common law governing charity. An organization that has one or more non-charitable purposes or devotes resources to activities undertaken in support of non-charitable purposes cannot be registered as a charity.

As above, registered charities are required to pursue activities in furtherance of the purposes for which they are established. There is some concern that the Charity is operating outside of its corporate mandate.

The Charity was registered "to provide relief to children and their families in Canada and in other countries who are suffering as a result of extreme poverty, natural or man-made disaster, war or insurrection, or homelessness; to receive grants or donations of cash or in-kind from individuals, corporations, government bodies or other associations for disbursement to children and families who are so afflicted; and to education the Canadian public concerning the needs of such children and families and concerning appropriate responses to those needs."

It is our view, based on our review, is that the Charity does not operate for wholly charitable purposes and the activities it undertakes on a day-to-day basis do not support its charitable purposes in a manner consistent with charitable law. In fact, the evidence on the file, as outlined below, demonstrates a preponderance of effort and resources devoted to non-charitable activities. The Charity has devoted a substantial portion of its efforts and resources to participating in two tax shelter donation arrangements, an

international donation arrangement and to fundraising with a comparatively minor portion of its resources devoted to its registered purpose.

**a. Tax Planning Donation Arrangements:**

During the audit period the Charity has participated in two registered tax shelters by agreeing to accept cash and/or property from donors and another registered charity participating in the tax shelter.

In 2003 the Charity participated in the Canadian Gift Initiatives ("CGI") tax shelter by agreeing to accept donations of pharmaceuticals, issue official donation receipts for the purported fair market value ("FMV") of the pharmaceuticals and to distribute the pharmaceuticals to organizations operating overseas. The Charity issued official donation receipts totalling \$18,883,621 or 87% of the Charity's total income in 2003 for the pharmaceuticals purportedly received. In exchange for issuing the official donation receipts, CGI was to donate 0.5% of the pharmaceuticals value in cash "gifts" to the Charity. Donation receipts were found to be 5-6 times the donors' purchase price of the pharmaceuticals and donors did not choose the pharmaceuticals they purchased. The tax shelter promoter, based upon the amount the donor wished to spend, selected the pharmaceuticals purchased. The pharmaceuticals were to be distributed on behalf of the Charity by Feed the Children, a U.S. organization headquartered in Oklahoma City during 2004. The Charity did not take physical delivery of the pharmaceuticals as they were held at a warehouse located outside Canada.

In 2003/2004 the Charity participated in the Canadian Hunger Relief Program ("CHRP") by operating as the distribution charity. The Charity accepted a donation of pure powdered barley grass, long grained white rice and cash from The Change Canada Charitable Foundation ("Change Canada") on December 10, 2003. The Charity received \$118,750 in cash, and goods valued at \$12,302,406 or 83% of the Charity's total income in 2004 from Change Canada. The values of the goods were at least 5 times the donors' purchase price. The barley grass and rice were to be distributed on behalf of the Charity by Global Relief Fund. Neither charity took physical possession of the goods, as the goods were stored outside Canada at all times.

As noted above, the Charity received cash "donations" from CGI and Change Canada for their participation in the donation arrangements, which, in our opinion is the Charity's compensation for lending its tax-receipting privileges and registered charity status to the tax shelter promoters. For the CGI tax shelter, the Charity netted \$4,600<sup>1</sup> for reporting and distributing goods valued at \$18.8 million. For the CHRP tax shelter, the Charity netted \$19,000<sup>2</sup> for reporting and distributing goods valued at \$12.3 million.

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<sup>1</sup> Charity received \$139,137 from CGI and paid \$134,449 in expenses to entities associated with the tax shelter.

<sup>2</sup> Charity received \$118,750 from The Change Canada Charitable Foundation and paid \$99,750 to Global Relief Fund to ship the goods.

The Charity has not demonstrated the activities undertaken or resources it consulted as part of its due diligence undertaken to evaluate the authenticity of the programs in which it participated, the existence of the goods involved, the value of the goods and the distribution of the goods. The documentation provided to date gives the impression the Charity relied upon the professional opinions provided by the tax shelter promoters. In fact, we would note the documentation provided in support of the Charity's due diligence, contained within binder entitled "CGI – Due Diligence" contained opinions issued to Canadian Gift Initiatives Corporation and an appraisal report prepared by Pharmaspec, Inc. to another participating charity, Escarpment Biosphere Foundation. We have not been provided with the professional opinions sought and prepared by persons unaffiliated with the tax shelter promoters.

From the Charity's conduct in these arrangements we are led to believe the Charity merely operated as a conduit for the identified tax shelters. As part of the programs, the Charity was engaged to accept the goods being promoted, to issue official donation receipts in the amounts predetermined by the tax shelter promoters and to distribute the goods to organizations predetermined by the tax shelter promoter. In most cases, the Charity has no interaction whatsoever with the donors or the end recipients, as this is handled entirely by the tax shelter promoters. The Charity, as set out below, cannot be certain that the goods for which it has issued tax receipts or otherwise received from another participating charity were received or received in the amounts represented. All of these facts point to a pattern of active willingness to participate in schemes designed to produce inappropriate tax benefits for the participant donors while producing a stream of revenue for the Charity. As is outline below, in our view this failure to conduct proper due diligence has also led the Charity to issue receipts for other than the FMV of the property received.

As above, the Charity does not appear to have evaluated the programs or the goods to be received prior to engaging in operations with the tax shelters. As we will discuss below, the Charity must retain direction and control over the use of its resources even if the charitable activities are being carried out by another organization. The Charity must be able to demonstrate at all times, through adequate books and records, that it was devoting resources to charitable activities as opposed to transferring resources to a non-qualified donee.

The Charity has provided the Memorandum of Understanding in place between itself and Feed the Children and Global Relief Fund. The memorandums outline each party's responsibilities for the shipping and distribution of the goods received by the Charity as a result of its participation in the tax shelter programs. Our review of the memorandum and related documentation fails to demonstrate the Charity distributed the goods as part of its own programs and provides further evidence the distributions were predetermined by the tax shelter promoters. As support, CGI's correspondence to the Charity on June 26, 2003 states "*we [CGI] have arranged for FTC [Feed the Children] to take on the distribution to the staging points. So I have included a copy of the MOU between the Agency [the Charity] and FTC.*" Additionally, the agent and representatives from the tax shelter predetermined the organizations (consignees) to receive the goods. The consignees were deemed to meet the qualifications of "*being located in a region of*

*great demand and demonstrated effectiveness in product delivery and reporting."* At no time was the Charity identified as being involved in the discussion and selection of the agent, Feed the Children, or the consignees.

It is our view the Charity enthusiastically lent its physical, financial and human resources (particularly with respect to its tax receipting privileges) to support these tax shelter arrangements, with little regard for the legitimacy of the arrangement and interests of the Charity itself. As above, the overwhelming majority of the property received by the Charity during the years in question was received through such arrangements – property the Charity neither saw, valued, or distributed itself, but rather was paid to issue tax receipts for 0.5% of the amount receipted. In our view, during these years the collateral purpose, if not primary purpose of the organization was, in fact, to support and promote tax shelter arrangements. Although these activities appear to be of a nature that they could fall within the Charity's mandate, it is clear that the Charity had little to no actual involvement in controlling and operating these programs. Operating for the purpose of promoting a tax shelter arrangement is not a charitable purpose at law. It is further our view, therefore, that by pursuing this non-charitable purpose, the Charity has failed to demonstrate that it meets the test for continued registration under 149.1(1) as a charitable organization "all the resources of which are devoted to charitable activities". For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

**b. International Donation Program:**

Aside from the Charity's participation in the tax shelters, the Charity's also reports a significant amount of donated goods (i.e., commodities) being distributed by the Charity internationally as part of its own charitable programs. During the audit period, the Charity has reported it has received and distributed over \$46.6 million of goods; \$15.4 million excluding tax shelter activities.

It is our understanding, from the information provided to us that the Charity receives goods from two main organizations, International Aid ("IA") and Universal Aide Society ("UAS"), exclusive of the goods received from its participation in the tax shelter programs. The goods received include a variety of medical goods, medicines, blankets, clothing, personal care items and so forth. International Aid or Universal Aide Society valued each donation. The Charity reports the value provided by the organizations as both a gift from other charities and as a charitable program expense on its T3010. Prior to receiving each donation, the Charity is required to pay a certain amount to each organization. It is our understanding the amounts paid was to cover the shipping costs associated with shipping the goods to their predetermined place of distribution. Our understanding is based on the fact the Charity does not report shipping costs associated with the distribution of the goods in its original books of entry nor have we been provided with evidence to the contrary.

CRA acknowledges that it is not always practical for a registered charity to become directly involved in international charitable activities because of limited financial resources, the size of the project or because the charity lacks the necessary expertise

to operate effectively in a particular area of interest. Accordingly, CRA will consider that a registered charity is involved its own charitable activities if the charity demonstrates that it maintains the same degree of control and responsibility over the use of its resources by another entity as it would if its activities were conducted by the charity itself.

Where a registered charity chooses to operate through an appointed agent or representative, it must be able to substantiate, generally through documentary evidence, that it has arranged for the conduct of certain specific activities on its behalf, and has not simply made a transfer of resources to a non-qualified donee. A charitable organization is not at liberty to transfer funds or resources to other individuals or entities unless the recipient is an employee of the charity, an agent of the charity under contract, or a qualified donee. To this end, the charity must be able to demonstrate to the CRA's satisfaction that it maintains control over, and is fully accountable for, the use of resources provided to the intermediary, at all times.

The existence of an arrangement that demonstrates sufficient and continuing direction and control over, and full accountability for, all resources and related activities, is critical. The arrangement must establish that the activities in question are, in fact, those of the Charity.

Aside from the tax shelter programs, the audit has not revealed an agency relationship between the Charity and IA or UAS. The Charity has not presented the agency agreements in place between itself and the organizations nor do the facts presented indicate an agency relationship exists between the parties. In support of the Charity's relationship with IA, we were provided with a copy of the Charity's application form to become a recipient of goods from IA. The application form does not satisfy our queries as to how the Charity directs and controls the shipments and distribution of goods or what role IA has been engaged to undertake on behalf of the Charity. In support of the Charity's relationship with UAS, UAS states a contract or agreement does not exist, *"I don't believe that we need one or ever did. We are not particularly interested in developing one at this time."* The letter further states, *"Either CEF [Children's Emergency Foundation] has let us know what sort of shipments you need and where you want to send them and we make our best efforts to fill your needs; or we have made CEF aware of available containers and potential locations."* The letter, in conjunction with the other information available to us, fails to satisfy our concerns that the shipment and distribution of the goods were in fact part of the Charity's on-going charitable activities and were under the on-going supervision of the Charity.

Apart from the agency agreement, CRA also reviews the evidence provided by the Charity to support its assertion it conducted activities overseas and that these activities were those of the Charity. From the Charity's documentation provided in support of its activities overseas, it fails to prove the Charity's active and on-going direction and control of its programs overseas. The audit was unable to reveal the criteria utilized by the Charity to identify and select qualified and competent organizations to work with; the criteria employed to determine which entities would receive goods and in what quantities; the directions provided to the agents for shipping,

storage and distribution; and the periodic reports received from the agents supporting its on-going activities undertaken on behalf of the Charity.

The audit was also unable to uncover the documentation, if any, maintained by the Charity to support its international activities. The Charity did not provide warehousing, shipping or transportation documents even though the goods received from IA and UAS were allegedly in the Charity's possession for periods of time before shipping if we are to believe the Charity's assertion the actual goods were in fact donated to it. The Charity provided various reports completed by the consignee organizations however it is our view the reports were not completed at the request of the Charity nor do the reports contain the level of detail necessary to substantiate the consignee received the goods purportedly received by the Charity from IA or UAS then donated by it.

It is our position the Charity has not demonstrated the international activities it has reported were programs executed and controlled by the Charity. Further, the Charity has failed to demonstrate the goods it represents it has received and distributed have actually been received and distributed and particularly in the amounts represented. As such, we are not prepared to recognize the amounts reported as commodity distributions, tax shelter or otherwise, as expenditures incurred for charitable purposes. Additionally, the Charity has expended nearly \$270,000 of its tax-receipted donations on its acquisition of commodities and we are not prepared to accept this expense to be incurred for charitable purposes.

Based on the lack of documentation and tangible evidence, it does not appear the Charity has maintained effective control and direction over the use of its goods and thereby, has distributed its resources to a non-qualified donee. Pursuant to paragraph 168(1)(b) of the ITA, the Minister may give notice to a registered charity that he proposes to revoke its registration where a registered charity ceases to comply with the requirements of the ITA for its registration as such. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

### **c. Devotion of Resources:**

The Charity receives and devotes a substantial portion of its actual cash contributions to fundraising. The Charity has employed the professional fundraising services of Xentel DM Incorporated and The Responsive Marketing Group to raise funds for the Charity and compensates each based on an agreed rate per hour or per presentation. During the audit period, the Charity has received over \$8.2 million and has paid over \$4.5 million, or 55% of total fundraising revenues, for these telemarketing services. By comparison, the Charity has reported only \$1.9 million in program payments distributed to the various community groups and schools administering meal programs for underprivileged children.

In reviewing the Charity's records, it has reduced its total party fundraising expenses by 20% and recorded this reduction under the heading "Education and

Advocacy". The Charity therefore does not report the gross fundraising expense actually incurred in its financial statements or in its annual information return. The Charity's rationale for reducing gross fundraising expenses is a belief that a portion of the scripts used to solicit funds contained information about the Charity's purpose. CRA's position is, as outlined in our publication "Completing the Registered Charity Information Return – T4033A", total fundraising costs are the total expenses a registered charity pays out for fundraising activities whether carried out by the charity or by contracted third parties. Our position is expanded further to consider the purpose behind the expenditure when determining whether the expenditure is a qualifying expenditure for purposes of the disbursement quota. It is our position the third party fundraisers were engaged to solely solicit funds and accordingly, all amounts paid to the third party fundraisers should have been reported as fundraising expenditures only.

Based on our calculations, the Charity receives, on average, 84% of its total tax-receipted cash gifts<sup>3</sup> from third party fundraising and to earn this income, pays on average 49% of its total tax-receipted cash gifts to the third party fundraisers. These figures illustrate our view the Charity has devoted its resources to non-charitable purposes.

To further illustrate how, in our view, the Charity has devoted its resources to non-charitable activities, we have adjusted the T3010 to record our findings and to classify expenses we consider non-charitable as either administration or fundraising. Refer to Appendix "A". Based on our revisions, the Charity has expended 83% of its total income on tax shelter and international donation programs while expending 10% on fundraising and only 6% its own charitable programming.

It is our view that by pursuing these non-charitable purposes, the Charity has failed to demonstrate that it meets the test for continued registration under 149.1(1) as a charitable organization "all the resources of which are devoted to charitable activities". For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

## **2. Failure to Accept and Issue Receipts for Valid Gifts:**

It is our position that the Charity has contravened the *Income Tax Act* by accepting and issuing receipts for transactions far in excess of amounts that would be considered not reflective of the goods actual fair market value and not reflective of the donor's eligible amount of the gift. We offer the following explanations to support our position.

**Due Diligence** - We note with concern, with respect to this particular issue, that it appears that the Charity's directors have demonstrated a lack of due diligence with respect to receipting practices. In fact, and as above, we feel that the duty of the

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<sup>3</sup> Total tax-receipted cash gifts calculated as total tax-receipted gifts reported at line 5000 of the T3010 less any tax-receipted gift in kind gifts.



directors to operate in the best interests of the Charity has been sidetracked by its collusion with the tax shelter arrangements.

As discussed above, the Charity has failed to demonstrate due diligence and relied entirely upon the opinions and valuation reports provided by the tax shelter promoters.

As previously stated, this has resulted in the Charity issuing receipts for property it did not even see or receive or, as above, even use in its own programs. The Charity did not even interact at all with the participants, but instead purportedly received gifts of pharmaceuticals and food through arrangements primarily designed to allow participants to profit from the tax system from an overvaluation of the property donated. As described below, it is the opinion of the CRA that this complete lack of due diligence has resulted in the Charity issuing receipts and recording gifts for far in excess of the actual fair market value of the items donated.

**Fair Market Value** - When a registered charity receives a gift-in kind donation, whether tax receipted or not, by way of transfer of legal title or receipt of beneficial ownership, the value of the gift would be its fair market value. It is the responsibility of the charity to ensure independent appraisals are obtained, and the charity may not simply rely on valuations provided by the donor. An independent qualified appraiser should determine the fair value, especially for gifts of more than \$1,000.

"Fair market value" is not defined by the ITA, however, a standard definition generally accepted is, the highest price obtainable in an open and unrestricted market between informed, prudent parties dealing at arm's length and under no compulsion to buy or sell<sup>4</sup>.

As found in another court case<sup>5</sup>, factors such as the item and whether it is sold as an individual item or in bulk, and the relevant market where goods are acquired and distributed, could affect the valuation of the goods. For example, medicines acquired outside of Canada, and distributed as humanitarian aid internationally, could have different values in comparison to medicines sold in a retail pharmacy in Canada.

It is our position the conclusion made by Rothstein, J.A. also applies to all donations of non-cash property to the Charity. Based on the quantities donated, the relevant asset is considered to be the group of goods donated, not the individual items within each group. Rothstein, J.A. continues by stating it is wrong to assume that the fair market value of a group of items is necessarily the aggregate of the price that could be obtained for the individual items in the group.

Another factor that may also affect the value would be the condition of an item. For example, items that are close to their expiration date, or obsolete, or second-hand,

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<sup>4</sup> *Henderson Estate & Bank of New York v M.N.R.* 73 D.T.C. 5471 et 5476.

<sup>5</sup> *AG (Canada) v Tolley et al* 2005 FCA 386

could have different values than items with longer shelf lives, or that are state-of-the-art or brand new goods. It is our position that the non-cash gifts received from IA and UAS were not evaluated on this basis as it is our understanding the Charity did not physically inspect the goods nor was this level of description provided to the Charity.

Based on our findings, the FMV recorded on the donation receipts issued in the CGI tax shelter and the FMV recorded for the gifts received Change Canada are not indicative of the factual FMV of the goods donated as the values were based on suggested retail prices. We are of the opinion the retail market is not the relevant market as the goods were acquired, sold and donated in blocks of goods; therefore the more relevant market is the wholesale market. CRA Valuations have determined the FMV of the pharmaceuticals to be the supplier prices in the 2003 International Drug Price Indicator Guide and the FMV of the rice and barley grass to be no more than the purchase price of the goods.

We are also of the opinion the value reported for the goods received from IA and UAS are not indicative of the factual FMV of the goods. The Charity has not shown that the values reported are indicative of the FMV of the goods.

In *Klotz v The Queen* 2004 TCC 147, Bowman, A.C.J. stated "It is an interesting question that I need to consider here whether the price paid for something is truly indicative of fmv [sic-fair market value] where the predominant component in the price paid is the tax advantage that the purchaser expects to receive from acquiring the object."

The audit found that the Charity consistently used the values provided by the donors of the goods and did not seek independent valuations for the goods received nor did it physically inspect the goods received. In each instance where the Charity was provided with a value for the goods, the Charity has not shown the due diligence undertaken by the Charity to certify the goods belonged to the Charity, in the quantities reported, and that the values recorded were the FMV of the goods.

**Eligible Amount of a Gift** - To determine the eligible amount for receipting purposes, the value of the advantage must be subtracted from the value of the gift. Under proposed legislation, the eligible amount of the gift is the amount by which the fair market value of the gifted property exceeds the amount of an advantage, if any, in respect of the gift.

An advantage is what a donor may receive in return for his donation, and it must be taken into consideration when determining the eligible amount of a gift for receipting purposes. The advantage is generally the total value of all property, services, compensation, or other benefits that a person is entitled to receive as partial consideration for, in gratitude for, or is in any other way related to the gift. The advantage may be contingent or receivable in the future, either by the donor or a person or partnership not dealing at arm's length with the donor.

The receipts issued by the Charity in relation to The ZIM Project mission membership fail to report the eligible amount of the gift. As per "The ZIM Project Application" form, applicants are required to pay a membership fee to the Charity, which includes airfare, ground transportation, meals while on mission, accommodation, medical and travel insurance. The membership fee is fully tax-receipted by the Charity.

As such, our position is the Charity failed to deduct the cost of the expenditures incurred on behalf of the applicant from the tax-receipted membership fees.

**Directed Donations** - Gifts subject to a direction by the donor that the charity transfers the funds to a specified person or family are not considered gifts and therefore cannot be acknowledged by an official donation receipt. In such an instance, the donor has made a gift to the person or family and not to the charity.

Receipts were issued for directed donations. Referencing "The ZIM Project Application" once more, the form encourages applicants to solicit donations from family, friends and others to be submitted towards an applicant's membership fee.

Under paragraphs 168(1)(d), the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration if it issues a receipt otherwise than in accordance with the ITA and its Regulations. It is our position that the Charity has issued receipts otherwise than in accordance with the ITA and the Regulations. For each reason identified above, there are grounds for revocation of The Children's Emergency Foundation's charitable status.

### **3. Failure to Issue Receipts in Accordance with the ITA:**

The law provides various requirements with respect to the issuing of official donation receipts by registered charities. These requirements are contained in Regulations 3500 and 3501 of the ITA and are described in some detail in Interpretation Bulletin IT-110R3 *Gifts and Official Donation Receipts*.

The audit reveals that the donation receipts issued by the Charity do not comply with the requirements of Regulation 3501 of the ITA and IT-110R3 as follows:

- Receipts issued to acknowledge goods received as a result of the Charity's participation the CGI tax shelter were not independently appraised by the Charity. Official donation receipts were issued based on the figures provided by the appraisers hired by the promoters of the tax shelters. The appraisals were, therefore not conducted at arm's-length. The result, as above, is that the FMV of the property donated was not accurate.

Additionally, we would like to inform you that certain amendments to the ITA were introduced as part of Bill C-33 tabled in Parliament on March 23, 2004, that came into force May 13, 2005. As part of the amendments, a registered charity that issues an official donation receipt that includes incorrect information is liable to a penalty equal to

5% of the eligible amount stated on the receipt. This penalty increases to 10% for a repeat infraction within 5 years.

A registered charity that issues an official donation receipt that includes false information is liable to a penalty equal to 125% of the eligible amount stated on the receipt, where the total does not exceed \$25,000. Where the total exceeds \$25,000, the charity is liable to a penalty equal to 125% and the suspension of tax-receipting privileges.

Additionally, charities may be subject to third party civil penalties for their involvement in a tax shelter arrangement. Effective June 29, 2000, third parties are subject to civil penalties for making misrepresentations in respect of tax matters that could result in their clients making false statements or omissions on their returns, which include overstating the fair market value of a property donated. These penalties are based on the amount of tax evaded and the gross revenues earned by the third party providing information or services to taxpayers.

Due to the seriousness of the areas of non-compliance identified during the audit, we feel there are sufficient grounds for revocation of the Charity's registered status and as such, penalties are not being considered at this time.

Under paragraphs 168(1)(d) of the ITA, the Minister may, by registered mail, give notice to the registered charity that the Minister proposes to revoke its registration if it issues a receipt otherwise than in accordance with the ITA and its Regulations. It is our position the Charity issued receipts for transactions that do not qualify as gifts at law. For this reason alone, there are grounds for revocation of the charitable status of The Children's Emergency Foundation under paragraph 168(1)(d) of the ITA.

#### **4. Failure to Meet Disbursement Quota:**

In order to maintain its status as a charitable organization within the meaning of paragraph 149.1(2)(b) of the ITA, a registered charity must, in any taxation year, expend amounts that are equal to at least 80% of the aggregate amounts for which it issued donation receipts in its immediately preceding taxation year. A charity is allowed by virtue of 149.1(20) of the ITA to offset any shortfalls in its disbursement quota by applying any excesses in its disbursement quota from its immediately preceding taxation year and 5 or less of its immediately subsequent taxation years.

In considering the application of expenditures used to meet the disbursement quota a charity must ensure that it is expensed directly on charitable activities and/or programs. This would include such payments as salaries to persons performing duties directly related to a charitable program, but would not include amounts paid for purely administrative expenses such as fundraising costs, legal or accounting fees and the like.

Based on our calculations, and for the reasons described in detail above, the Charity has not met its disbursement quota for the fiscal periods ending December 31, 2002 to December 31, 2005 due to:

- Amounts reported as distributions of pharmaceuticals, powdered barley grass and rice are not being recognized at the values provided to and used by the Charity. As discussed above, the Charity has been unable to substantiate the factual value of the property distributed, that the goods were actually distributed and that the programs were carried on as programs of the Charity.
- Amounts reported as international commodity distributions and commodity acquisition expenses are not being recognized as charitable expenditures as the Charity has not demonstrated the international commodity distributions were programs executed and controlled by the Charity.

The audit found that the Charity consistently used the values provided by IA and UAS to record the gift of and distribution of goods received from each organization and has not shown it sought independent valuations for the goods received nor has it demonstrated it physically inspected the goods received. We are of the opinion the Charity chose to report the value of the non-cash property provided in an endeavour to increase the amounts it reported as expenditures on charitable activities. As we discussed above, the Charity devotes a substantial amount of its tax-receipted cash donations to non-charitable activities such as fundraising, commodity acquisition and administration, and without the donations of non-cash property, the Charity would find it difficult to meet its annual disbursement quota.

In comparison to the donors participating in the tax shelter arrangements, the Charity was required to contribute a minimal investment or was paid a minimal amount in order to obtain property valued in the hundreds of thousands or millions of dollars.

For the goods received from IA and UAS, the Charity incurred commodity acquisition costs of \$270,000 but received property with values assigned at \$15.4 million. The non-cash gifts had little impact on the financial statements other than increasing the Charity's total income and total expenses but the true significance of the non-cash gifts was unmistakable in the Charity's classification of these gifts as charitable expenses for disbursement quota purposes. As a result of the Charity's classification of the non-cash property as charitable expenses, the Charity was able to report it had met its annual disbursement quota and was able to accrue disbursement quota excesses of \$27.4 million up to the end of fiscal period ending December 31, 2005. Based on our calculations, the Charity has a disbursement quota shortfall of at least \$20.3 million. It is evident to CRA that the Charity's "advantage" received from receiving these goods was the disbursement quota excesses it has accrued despite devoting a major portion of the Charity's net cash to fundraising and administration expenses.

We have calculated the Charity's cumulative disbursement quota shortfall, a product resulting from the reclassification fundraising expenses and international distribution expenses from charitable program expenses to non-charitable expenses. Refer to Appendix "B".

As per paragraph 168(1)(b) of the ITA, the Minister may, by registered mail, give notice to the charity that the Minister proposes to revoke its registration because it ceases to comply with the requirements of the ITA related to its registration as such. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

#### **5. Failure to File an Accurate Registered Charity Information Return (T3010):**

Pursuant to subsection 149.1(14) of the ITA, every registered charity must, within six months from the end of the charity's fiscal period (taxation year), without notice or demand, file a Registered Charity Information Return with the applicable schedules.

It is the responsibility of the Charity to ensure that the information that is provided in its Return, schedules and statements, is factual and complete in every respect. A charity is not meeting its requirement to file an Information Return if it fails to exercise due care with respect to ensuring the accuracy thereof.

The Charity improperly completed the Information Return for the fiscal periods ending December 31, 2003 to December 31, 2005 in that many items reported were incorrectly identified or omitted. A summary of the incorrectly identified or omitted items are summarized in Appendix "A". Specifically the following items:

##### **FPE December 31, 2002**

- Total Fundraising expenses reported at line 123 and Total disbursements reported at line 128 were understated by \$229,760. The understatement is due to the Charity's reduction of gross fundraising fees by 20%.

##### **FPE December 31, 2003**

- The Charity failed to report the gift of cash and gift-in-kind property from The Change Canada Charitable Foundation, International Aid and Universal Aide Society on line 4510 - Total gifts received from other registered charities. Charity received \$118,750 cash and \$12,302,405.88 gift-in-kind donations from Change Canada as per donation letter dated December 13, 2003 and \$3,759,992 from International Aid and Universal Aide Society.
- Charity understated Total revenue from fundraising at line 4630 by \$1,179,505 as per reconciliation of books of entry (general ledger and financial statements).
- Total Fundraising expenses reported at line 5020 and Total expenditures reported at line 5100 were understated by \$249,816.

FPE December 31, 2004

- The Charity failed to report Total gifts received from other registered charities at line 4510. Total gifts received from other registered charities were understated by \$5,015,226.
- Charity failed to report Total expenditures before gifts to qualified donees at line 4950 in lines 5000 to 5040. Total expenditures of \$854,301 were not accounted for on lines 5000 to 5040.
- Total Fundraising expenses reported at line 5020 and Total expenditures reported at line 5100 were understated by \$281,221.

FPE December 31, 2005

- Total Fundraising expenses reported at line 5020 and Total expenditures reported at line 5100 were understated by \$237,904.

Under paragraph 168(1)(c) of the ITA, the Minister may, by registered mail, give notice to the charity that the Minister proposes to revoke its registration because the charity fails to file an Information Return as and when required under the ITA or a Regulation. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

**Gifts from The Change Canada Charitable Foundation** - As briefly discussed above, the audit revealed the Charity received "gifts" from another registered charity in 2003. The Charity has provided documentation showing it received cash of \$118,750 and in-kind donations of powered barley grass and rice valued at \$12,302,406 from Change Canada in 2003. The Charity failed to report the "gifts" so received on either the 2003 or 2004 Registered Charity Information Return but has reported the gifts in the financial statements and general ledger for 2004. Per the documentation made available during the audit, Ms. Jill McKinney delayed the deposit of the cash gift until January 2, 2004, the beginning of a new fiscal period for the Charity.

It is our view that one of the understood purposes of this cash "gift" was to disguise the actual relationship between the cash payments made to Change Canada by the participant donors and the amounts forwarded to Global Relief Fund by the Charity. Upon deposit of the cash "gift" in 2004, the Charity remitted a payment totalling \$99,750 to Global Relief Fund on January 5, 2004 purportedly for the costs associated with warehousing, shipping and distribution of the food items. It is our view the monies received from Change Canada were routed through the Charity as "gifts" from another registered charity essentially in an attempt to conceal the true source and nature of the transactions. In this regard, it is our view that the Charity has deliberately made false statements with respect to its annual information returns - grounds for revocation of its status under the ITA.

Additionally, it is clear that another purpose of these transactions is to artificially allow Change Canada to meet its disbursement quota. As such, it is clear, from the perspective of the CRA that one of the main purposes of this transaction was to enable

Change Canada to unduly delay the expenditure of amounts on actual charitable activities by simply characterizing these as gifts to the Charity.

Under subsection 149.1(4.1) the ITA, the Minister may revoke the registration of any charity where it can reasonably be considered that by accepting a gift from another charity it has acted in concert with that charity, for the purpose of avoiding the application of the disbursement quota.

#### **6. Failure to Prepare T4/T4A Documentation for Payments to Employee:**

Where salaries or wages are paid, the ITA requires annual T4 Summaries and T4 Statements of Remuneration Paid be prepared by the employer [Regulation 200(1)]. In addition to the salaries and wages actually paid, the T4 Summaries and T4 Statements of Remuneration Paid must also include the value of all taxable benefits conferred on employees in the year [paragraph 6(1)(a)]. T4 Summaries of remuneration paid must always be based on the calendar year.

In addition to the foregoing annual reporting requirements, where an employer pays an amount in respect of an individual's salary, that employer is required to withhold certain amounts from such payments [subsection 153(1)]. These amounts are in respect of income tax, Canada Pension Plan, Unemployment Insurance, etc. and the withholdings must be remitted to the Receiver General of Canada.

During the audit period the Charity paid remuneration to three individuals without preparing T4/T4A Summaries and T4/T4A Statements of Remuneration Paid. The Charity paid \$72,300 to Mr. Sam McKinney, \$7,000 to Ms. Hazel McKinney and \$117,721 to Brian Nelson Smith operating as BNS International. Each received regular remuneration from the Charity however the Charity has not shown the remuneration was related to a service provided by the individual to the Charity. We note the contract provided for Mr. Smith to operate as Director of International Programmes expired as of September 30, 1999. We also note the amounts paid to Ms. McKinney were for volunteer services however we have not been shown that all volunteers receive regular remuneration for their services volunteered. We have considered the amounts to be remuneration paid to employees as the Charity has not produced information to suggest the employees were operating as independent contractors.

#### **7. Failure to Maintain Adequate Books and Records:**

Pursuant to paragraph 230(2)(a) of the ITA, every registered charity shall keep records and books of account at an address in Canada recorded with the Minister or designated by the Minister containing information in such form as will enable the Minister to determine whether there are any grounds for revocation of its registration under this ITA.

In the course of the audit, the following deficiencies were noted:



- A reconciliation of the general ledger to the financial statements to the Registered Charity Information Returns (the "T3010") identified multiple instances whereby the amounts recorded in the general ledger were not recorded on the financial statements and/or the T3010. A summary of the figures recorded on the various records is summarized in Appendix "C".

It appears some of the discrepancies may be a result of the Charity's allocation of certain income and expenses between various accounts however the remaining discrepancies appears to be a result of failure to report certain income and expenses on the T3010.

- The Charity failed to maintain, obtain or provide documentation to support the receipt and distribution of non-cash property overseas as discussed above.

Under the *Income Tax Act*, failure to comply with keeping proper books and records may result in the suspension of a registered charity's tax receipting privileges or may result in revocation. Due to the seriousness of the areas of non-compliance identified during the audit, we feel there are sufficient grounds for revocation of the Charity's registered status and as such, suspension of the Charity's receipting privileges will not be applied at this time.

Under paragraph 168(1)(e) of the ITA, the Minister may, by registered mail, give notice to the charity that he proposes to revoke its registration because it fails to comply with or contravenes section 230 of the ITA dealing with Books and Records. For this reason, it appears to us that there are grounds for revocation of the charitable status of The Children's Emergency Foundation.

#### **The Charity's Options:**

##### **a) No Response**

You may choose not to respond. In that case, the Director General of the Charities Directorate may proceed with the issuance of a Notice of Intention to Revoke the registration of the Charity in the manner described in subsection 168(1) of the ITA.

##### **b) Response**

Should you choose to respond, please provide your written representations and any additional information regarding the findings outlined above **within 45 days** from the date of this letter. After considering the representations submitted by the Charity, the Director General of the Charities Directorate will decide on the appropriate course of action, which may include the issuance of a Notice of Intention to Revoke the registration of the Charity in the manner described in subsection 168(1) of the ITA.

If you appoint a third party to represent you in this matter, please send us a written authorization naming the individual and explicitly authorizing that individual to discuss your file with us.

If you require further information, clarification, or assistance, I may be reached at (613) 957-2212 or by facsimile at (613) 946-7646.

Yours sincerely,

Holly Brant  
Senior Audit Advisor  
Compliance Section

Cc: Marylynne Stewart, President

Enclosures