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DEC 21 2007

REGISTERED MAIL

Choson Kallah Fund of Toronto
26 Dell Park Ave.
Toronto, Ontario M6B 2T4

BN: 14026 3443RR0001
File #:0779140

Attention: Mr. E. Gross

**Subject: Notice of Intention to Revoke
Choson Kallah Fund of Toronto**

Dear Mr. E. Gross

I am writing further to our letter dated April 19, 2007 (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 Choson Kallah Fund of Toronto (the "Charity") in accordance with subsection 168(1) of the *Income Tax Act* (the "ITA").

We have now reviewed and considered the written responses dated June 7, July 20 and August 24, 2007 (copies without attachments enclosed) from your authorized representative David Goodman of Goodman, Solomon & Gold. However, notwithstanding your reply, our concerns with respect to the Charity's non-compliance with the requirements of the ITA for registration as a charity have not been alleviated. Our position is fully described in Appendix "A" attached.

Consequently, for each of the reasons mentioned in our letter dated April 19, 2007, I wish to advise you that, pursuant to the authority granted to the Minister in subsection 149.2(2) of the ITA, which has been delegated to me, I propose to revoke the registration of the Charity. By virtue of subsection 168(2) of the ITA, 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.

Business Number
14026 3443 RR 0001

Name
Choson Kallah Fund of Toronto
Toronto, Ontario

In accordance with subsection 168(2) of the ITA, you can suspend this process (i.e. seek an extended period before revocation) by applying to the Federal Court of Appeal or a judge of that court for a stay. The Court will acknowledge your application and provide you with an action number. We require a copy of the Court acknowledgement of your request for a stay to stop the revocation process.

Should you wish to appeal this Notice of Intention to Revoke the Charity's registration in accordance with subsection 168(4) of the ITA, a written Notice of Objection, which includes the reasons for objection and all relevant facts, must be filed within 90 days from the mailing of this letter. 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

Please note that, notwithstanding the filing of a Notice of Objection, the Charity must seek the above-noted stay to prevent revocation from occurring. Unless the Canada Revenue Agency receives notice that an application for a stay has been filed to the Federal Court of Appeal or judge of that court regarding this revocation, we intend to proceed with the publication of the above notice in the *Canada Gazette* in **30 days** thereby affecting the revocation of the organization's registration.

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 ITA, respectively;
- b) by virtue of section 188 of the ITA, the Charity will be required to pay a tax within one year from the date of the Notice of Intention to Revoke the Charity's registration. 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 the Charity's registration. A copy of the relevant provisions of the ITA concerning revocation of registration, the tax applicable to revoked charities, and appeals against revocation, can be found in Appendix "B", attached.

Form T-2046, and the related Guide RC-4424, "*Completing the Tax Return Where Registration of a Charity is Revoked*", are also included for your information; and,

- c) the Charity will no longer qualify as a charity for purposes of subsection 123(1) of the *Excise Tax Act* (the "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 1-800-959-8287.

Finally, I wish to advise that subsection 150(1) of the ITA 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 therefore.

Yours sincerely,



Terry de March
Director General
Charities Directorate

Attachments:

- CRA letter dated April 19, 2007;
- Your letters dated June 7, July 20 (without attachments) and August 24, 2007;
- Appendix "A", Comments on Representations;
- Appendix "B", Relevant provisions of the ITA;
- Form T-2046: *Tax Return Where Registration of a Charity is Revoked*; and
- Guide RC-4424E: *Completing the Tax Return Where Registration of a Charity is Revoked*

CHOSON KALLAH FUND OF TORONTO

COMMENTS ON REPRESENTATIONS OF JUNE 7, JULY 20
And AUGUST 24, 2007

Charitable Activities:

Non-Charitable Purpose

The audit conducted by the Canada Revenue Agency (the "CRA"), identified that Choson Kallah Fund of Toronto (the "Charity"), based on the activities of the Charity and the level of financial activity and resources devoted to this program, is operating primarily or collaterally for the purpose of furthering a tax shelter donation arrangement. In our view, the Charity's original purpose, which is to provide funding for relief of poverty to impoverished individuals, has been sidetracked by its participation in this arrangement and has, in effect, become a secondary purpose.

It is clear that, from our audit, the Charity has operated for the purpose of furthering a tax shelter arrangement by agreeing, for a fee, to act as the receipting agent in the arrangement. The Charity issues official donation receipts to "donors" for amounts predetermined by the promoter and immediately assigns the pharmaceuticals to another registered charity participating in the tax shelter arrangement. In return, the Charity is paid an amount equal to approximately 1.0507% of the tax-receipted amounts issued.

The representations of June 7, 2007 from Goodman, Solomon & Gold argue that the Charity did not promote the Program stating:

"The Charity had absolutely no involvement whatsoever with the initiation, promotion or administration of the [Canadian Humanitarian Trust tax shelter]. The Charity never promoted the Program to any individual or any group of individuals in any way shape of form...On no occasion did the Charity ever solicit a single donation of pharmaceuticals from anyone."

We do not doubt that the members of the Charity *themselves* did not promote the tax shelter scheme. However, we note that the Charity reported and incurred fundraising fees payable to World Health Initiatives Inc ("WHI"). WHI is responsible for the promotion and solicitation of the "donors" who make gifts to the Charity. As such, we disagree with your characterization that the Charity does not promote the program. In fact, it appears that the Charity is, by contracting WHI for fundraising, clearly involved in the promotion of this program.

Nonetheless, our view that the Charity has operated for the purposes of promoting a tax shelter arrangement is not solely based on the Charity's part in the *solicitations*. As detailed in our previous letter, it is our view that the overall conduct of the Charity in this arrangement demonstrates that the Charity is operating to promote and support a tax shelter arrangement and is operating for the benefit of the tax shelter promoters.

As detailed in our previous letter, despite neither being established for the promotion of health nor being involved in international activity, between 2004 and 2005, the Charity issued receipts in excess of \$177 million or 90% of the Charity's total income for donations of pharmaceuticals earmarked for international programs. (We note in 2006 alone, although this year is not a subject of review, the Charity issued receipts totalling over \$131 million.) This represented a dramatic increase in the volume of tax receipts being issued by the Charity in previous years (on average between \$4-6 Million). In its defence of the Charity's issuance of receipts for this program, the Charity states:

"Rabbi Gross, on behalf of the Charity made an agreement with WHI that if individuals were to offer packages of pharmaceuticals as a donation the Charity would accept such donations...The Charity further agreed with WHI that once the donation was accepted the Charity would donate the received pharmaceuticals to the Foundation so they could eventually be distributed to needy people in third world countries."

This agreement demonstrates that the Charity had no actual interest in the property for use in its programs. Indeed, in our view, this agreement demonstrates that the Charity was merely operating as the receipting agent in this arrangement – issuing receipts for property it did not see, need or want and passing this property to a third-party organization. It appears the only benefit to the Charity was, as above, the 1.0507% it was paid for its part.

The Charity did not conduct an independent review of this program to determine whether it was compliant with the *Income Tax Act* (the "ITA"). The Charity, despite being asked to issue receipts for over \$177 million in pharmaceuticals did not seek to *independently* verify the values being represented. We note, in the June 7, 2007 representations, the Charity indicates due to the high volume of donations, an administrator, WHI, and a valuator, Mr. Wayne Marigold, were engaged. The August 24, 2007 representation however confirms these individuals were referred to the Charity by WHI, acting as the tax shelter's promoter.

The Charity in this program had no interaction with donors whatsoever beyond the issuance of receipts for this program. The Charity did not see or physically receive the pharmaceuticals. The Charity was informed of the value of the property purportedly donated to it and instructed who to issue receipts to and in what values. The Charity took no steps to determine how participation in this program, beyond being paid for its participation, furthered its mandate. The Charity itself had no use for the pharmaceuticals in its own programs. The Charity agreed to "gift" the pharmaceuticals it had received, but not seen, to a third-party charity pre-arranged by the promoter.

In this regard, it is difficult to see how the Charity's participation can be characterized in any other way but as being paid to act as the receipt issuing entity in a tax shelter arrangement. We note, seemingly in its defence of its participation in this arrangement, the Charity argues the following in respect of its issuance of receipts:

"[N]either Rabbi Gross nor any member of the board nor anyone else connected with the Charity has ever seen any promotional materials connected with the program..."

Even if we were to believe this statement, it is of great concern to the CRA that, despite issuing receipts for \$177 million¹ for property the Charity has never seen that the principals of this Charity would take no active interest in reviewing the program in which it participated. In our view, this is a fundamental requirement of the board of directors of any Charity and particularly so, from an ITA perspective, when the issuance of tax receipts are involved. In any event, we consider this statement difficult to believe given the Charity's representations attesting to the measures it took to verify the legal validity of the arrangement and the values of the pharmaceuticals.

Accordingly, it remains our view that the Charity has willingly lent its name and tax receipting privileges to the tax shelter in exchange for monetary compensation. In our view, the Charity has participated in a program designed to abuse the charitable gift incentive provisions of the ITA. The Charity's participation in this program is to issue receipts for property it neither uses nor sees for values established by the shelter promoters. The Charity is compensated for its participation for a set fee representing scant 0.05% of all donation receipts issued (after deducting expenses). The Charity issued tax receipts for amounts in excess of \$177 million during the years under review. In our view, the Charity's participation in this program has become an end in and of itself. Accordingly, it is our view that the Charity has operated for the non-charitable purpose of promoting and participating in a tax shelter arrangement and, accordingly, cannot be considered to be a charitable organization *all the resources of which are devoted to charitable activities*.

As the Charity has not devoted all of its resources to its own charitable activities or by way of gifts to qualified donees, it has failed to meet the definitional requirement of paragraph 149.1(1)(a) of the ITA. Therefore under paragraph 168(1)(b) of the ITA, the Minister, may by registered mail give notice to the organization 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 Choson Kallah Fund of Toronto.

Devotion of Resources to Charitable Activities

Our audit revealed the Charity does not maintain or request the documentation necessary to prove the individuals are objects of charity nor does the Charity have defined selection criteria to establish financial need of the applicants; a repeat of our findings from the audit of fiscal period ending December 31, 1995. Additionally, the audit revealed incomplete or missing application forms.

The Charity's representations do not address any of these concerns. The fact that the Charity relies upon an application process, endorsed by individuals or organizations deemed reputable, or personal knowledge of the applicant is not sufficient to demonstrate to the

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¹ Exceeding \$300 million if one includes 2006.

satisfaction of CRA that the applicants were objects of charity. As noted above, the Charity does not appear to be adhering to its own application process. The Charity provided the Board of Director minutes which list the persons approved to receive financial aid however our audit revealed that financial aid was being provided to persons other than those on the approved list. This leads us to believe that the Charity is providing financial aid to persons who have circumvented the Charity's application process and have received financial aid for reasons unknown. The Charity seeks guidance on what constitutes poverty in the June 7, 2007 letter yet notes it decides whether an applicant meets the "poverty" test in the August 24, 2007 letter. The representations fail to specify the criteria employed by the Charity to ascertain that applicants are objects of charity.

The audit revealed application forms requesting funding for a variety of reasons many of which are not associated with poverty (e.g. wedding assistance, fertility treatments, private debts). The Charity has committed to changing their policy such that its focus will be on the relief of poverty as per the June 7, 2007 letter.

Per our previous letter, the Charity has not restricted its activities, i.e., the disbursement of funds, only to activities that are considered charitable-at-law, nor has it sought or maintained documentation to demonstrate that the beneficiaries are proper objects of Charity. As such, it is the view of the CRA that the Charity has ceased to qualify for its registration as a charitable organization all the resources of which are devoted to charitable activities.

For these reasons, and those set out in our letter of April 19, 2007, we continue to be of the view that the Charity is not devoted substantially all of its resources to its own charitable activities or by way of gifts to qualified donees. Therefore under paragraph 168(1)(b) of the ITA, the Minister, may by registered mail give notice to the organization that he 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 Choson Kallah Fund of Toronto.

Gifts:

Animus Donandi

Our position remains that the cash donations received by the Charity from "donor" participants and the other participating charity are not valid gifts under section 118.1 of the ITA due to the fact that the primary motivation of the donor was not to enrich the Charity, but through a series of artificial transactions and a minimal monetary investment, to make a profit through the tax credits so obtained.

In your June 7, 2007 letter you argue:

"While Rabbi Gross and his Board cannot speak to the actual motivations of any of the Charity's donors including those who donate cash for the Charity's other charitable activities, the courts have been clear on this matter that the law allows donors to give donations to charity even if the prime motivation is in order to gain a tax benefit."

It is incumbent on a charity to determine whether a transaction qualifies as a gift before issuing a tax receipt given that a tax receipt can only be issued for gifts *at law*. We agree that the tax credit available with respect to a donation is not usually an advantage or benefit that would affect whether a gift is made. We also acknowledge that in certain limited cases in the past taxpayers have profited from making gifts of property to registered charities. However, these cases generally involve the somewhat *rare and unusual circumstances* where taxpayers have been able to acquire valuable property at bargain prices. However, it is our view that arrangements that are mass-promoted promising participants that, through a series of artificial transactions (usually involving the bulk purchase of property), the participant will be able to claim tax credits for charitable donations far in excess of the expenditures actually made lack the requisite *animus donandi* for the transactions to be considered gifts.

Per our previous letter, promotional packages promise participants a substantial return on investments (i.e., profit) through the tax credits available. For a fee guised as a donation to a charity, participants suddenly become eligible for a distribution of "Medical units" from a trust. Despite the units being worth *hundreds of millions of dollars*, the trust then charitably distributes these pharmaceuticals to the worthy applicants. The donors "choose" to immediately donate these valuable medicines to the Charity,² despite having little to no knowledge or connection to the Charity. Neither the Charity nor the donor ever physically see or physically receive the property. The purported fair-market value of the "medical units", which has been pre-established by the promoters of the arrangements, is many-times higher than the donor's cost to participate in the arrangement. We remain of the view that participants in this arrangement are primarily motivated by the desire to profit from the artificial manipulation of the tax incentives available from donations rather than a desire to enrich the participating charity and, as such, lack the requisite *animus donandi* for the transaction to be considered as a gift. As such, we remain of the view that the Charity was not entitled to issue a receipt in these circumstances.

Even were the CRA to accept that these transactions qualified as gifts, which, as above, we do not; it is our view that proposed subsection 248(38) applies to these transactions. As you may be aware, proposed subsection 248(35) provides that, where a taxpayer acquires property through a gifting arrangement the fair-market value of that property is deemed to be the lesser of the actual fair-market value and the cost to the donor. It is our view that the purpose of the use of the trust into this arrangement can reasonably be considered to be designed to avoid the application of subsection 248(35) and as such, 248(38) applies. Subsection 248(38) is applicable to gifts made after December 5, 2003, and, where it applies, deems the fair-market value of the property to be the lowest cost of that property to the taxpayer to acquire the property *at any time* (for gifts made before July 18, 2005) or nil (for gifts made after July 18, 2005).

As such, it remains our view that the Charity issued receipts for transactions that do not qualify as gifts *at law*. For this reason, it appears to us that there are grounds for revocation of the charitable status of Choson Kallah Fund of Toronto under paragraph 168(1)(d) of the ITA.

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² We would also note that the "voluntariness" of the transaction is questionable given that the pharmaceutical units could not be imported into Canada without the appropriate government issued licences and the quantities and nature of the pharmaceuticals would be beyond a prudent persons use.

Fair-Market Value

It is also our position that the value recorded on the official donation receipts is not indicative of the fair market value of the units donated.

The Charity outlines in its representation letters the actions that were undertaken to attest to the donors' legal ownership of the pharmaceutical units and to attest to the fair market value of the units. However, as stated above, each of the persons or organizations involved in these steps were in some way related to the tax shelter.

Per our previous letter, it remains our view that the fair-market value of the property has been inaccurately assessed. The appraised values are based on a suggested *retail* price that is not the relevant market. In our view, especially considering the way in which the gifting arrangement is marketed (i.e., on a national scale and allowing almost unlimited purchases), the fair market value is reflected by the last known arm's length price paid for the goods – i.e., the participant's price to participate in the tax shelter arrangement.

Further, your representations have not altered our position as to the valuation of the pharmaceutical units donated. The valuator's method of reviewing the pharmaceutical units does not provide assurance the pharmaceuticals were actually inspected to attest to their existence, quality and quantity as Mr. Marigold reviewed the inventory list of pharmaceuticals being offered for donation. The valuations provided by Mr. Marigold were also based on Ontario suggested retail values of the individual pharmaceuticals in the package being offered for donation. Our findings, as outlined in our April 19, 2007 letter, state the relevant asset to be valued is the group of items rather than the individual items within the group. Additionally, CRA has been advised the pharmaceutical units were manufactured outside of Canada and were never imported or used in Canada due to Regulations and, as such, the relevant market *cannot* be the Ontario retail market.

As such, for the reasons set out herein and in our previous letter we remain of the position that the appraised values relied upon by the Charity are not accurate reflections of the fair market value of the property.

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 the Regulations. For this reason, it appears to us that there are grounds for revocation of the charitable status of Choson Kallah Fund of Toronto.

T3010:

The Charity reported gifts received from other registered charities on the Registered Charity Information Return (T3010A) however we do not recognize the cash donations received as gifts made to the Charity. The amounts received were earmarked to pay the Charity's expenses associated with the tax shelter arrangement. This fact is confirmed by the Charity's June 7, 2007 representations which states "*The fees required to pay the outsourced administration company...and the fees required to pay the outside valuation expert...were paid by the Foundation (Escarpment Biosphere Foundation).*"

Official Donation Receipts:

The Charity's representations and our comments regarding the issuance of receipts for goods that do not qualify as gifts as per ITA 118.1 and the value indicated on the receipts has been addressed above. The Charity has failed to address or undertake actions to correct the other areas of concern noted in our April 19, 2007 letter.

Other Concerns:

We accept the Charity's undertakings to file the T3010A Registered Charity Information accurately and within six months from the end of each fiscal period; and to prepare and file T4/T4A Summaries and Statements of remuneration paid for each person employed on a part or full time basis.



BY REGISTERED MAIL

Choson Kallah Fund of Toronto
26 Dell Park Ave.
Toronto, Ontario M6B 2T4

BN: 14026 3443RR0001
File #: 0779140

Attention: Mr. E. Gross

April 19, 2007

SUBJECT: Audit of Choson Kallah Fund of Toronto

Dear Mr. Gross:

This letter is further to the audit of the books and records of Choson Kallah Fund of Toronto (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, 2003 to December 31, 2004. A review the Registered Charity Information Return (the "T3010") of fiscal period ending December 31, 2005 was also performed.

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:

AREAS OF NON-COMPLIANCE:		
	Issue	Reference
1.	Charitable Activities	168(1)(b)
2.	Gifts	118.1
3.	Official Donation Receipts	Regulation 3501, 168(1)(d)
4.	Disbursement Quota	149.1(2)(b)
5.	Registered Charity Information Return (T3010)	168(1)(c), 149.1(2)
6.	Late Filing of T3010	168(1)(c), 149.1(2)

7.	Remuneration and Benefits Reporting	Regulation 200(1), 6(1)(a)
8.	Books and Records	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 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:

Charitable Activities and Purpose:

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. Firstly, the purposes it pursues must be wholly charitable and secondly, 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.

The Charity was registered "to receive and maintain a fund or funds and other property and to apply from time to time all or part thereof and the income therefrom for charitable purposes including, without limiting the generality of the foregoing, the making or awarding, if and when the Corporation may from time to time deem it advisable, of gifts or awards of financial assistance to individuals, organizations or institutions for the relief of poverty."

It is our view, based on our review, is that the Charity does not operate for charitable purposes. In fact, the evidence on the file, as outlined below, demonstrates that the preponderance of effort and resources of the Charity are devoted to participating in a tax planning donation arrangement while an incidental and comparatively insignificant amount of effort and resources are devoted to charitable programming. Operating for

the purpose of promoting a tax planning donation arrangement is not a charitable purpose at law.

The Charity has participated in the Canadian Humanitarian Trust tax shelter (TS69310) for fiscal periods 2004, 2005 and 2006 by agreeing to accept cash and/or property from taxpayers and registered charities that were also participants in the tax shelter. Participants make cash donations to a participating charity and subsequently apply to be a beneficiary of a trust. As beneficiaries of the trust, the participant receives medicine units at their adjusted cost base and donates the medicine units to the Charity as a gift in kind donation. The Charity issues official donation receipts for the gift in kind donation at fair market value.

The Charity accepted the gift in kind donations from participants and transferred the medicine units to another participating charity, Escarpment Biosphere Foundation. In turn, Escarpment Biosphere Foundation made a cash donation to the Charity in the amount of 1.057% of the receipted value of the medicine units. The Charity also incurred fundraising and administrative expenses amounting to 1% + GST of the receipted value of the medicine units and cash received by it payable to World Health Initiatives Inc. ("WHI").

In 2005, the Charity reports total assets of \$28,323,002: \$25,514,381 (90.1%) represents inventory of pharmaceutical units, and \$2,808,621 represents items such as bank account, investments and receivables which may possibly be considered partially related to charitable activities. The Charity also reports total expenditures of \$95,931,716: \$88,762,587 (82.5%) represents gifts of pharmaceutical units gifted to Escarpment Biosphere Foundation Inc, \$5,843,729 (6.1%) is charitable expenses, \$1,269,225 (1.3%) is fundraising fees paid to WHI and the remaining as management expenses. The Charity reports total expenditures in 2004 of \$69,171,630: \$63,255,524 (91.4%) represents gifts of pharmaceutical units gifted to Escarpment Biosphere Foundation Inc, \$5,817,047 (8.4%) is charitable expenses, \$99,159 (<1%) is management expenses and fundraising fees.

This low ratio of expenditures disbursed for charitable purposes and the low amount of assets that are used for charitable purposes appears to indicate that the Charity is not devoting all its resources to "charitable purposes".

In the donation arrangement identified above, the Charity has relied upon the professional opinions provided by the promoters of the donation arrangement and sought a review and opinion from Lipman, Zener & Waxman LLP. The Charity did not seek an alternative opinion as to the valuation of the goods involved. In the letter from Lipman, Zener & Waxman LLP dated April 27, 2004, it states "The persons issuing the Valuations should be qualified appraisers experienced in the valuation of the items comprising the Medicine Units, including in particular, pharmaceuticals and should be independent of each of the Settlor, the Trust, the Promoter and the Donors, and should not otherwise participate in the Program." The valuator contracted by the Charity is not independent of the Settlor, Trust or Promoter as each participates in the donation

arrangement. The Charity did not undertake any additional efforts to corroborate or contradict the opinions provided by persons directly associated with the tax shelter promoters.

From the Charity's participation in the tax shelter we are led to believe the Charity is merely operating as a conduit for the identified tax shelter since 2004. As part of the program, the Charity enables itself to accept the goods being promoted and to issue official donation receipts for the amounts predetermined by the tax shelter promoter. The Charity did not appear to evaluate the program or the goods to be received prior to engaging in operations with the tax shelter. 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 another organization.

Aside from the Charity's participation in the tax shelter, the Charity's other activity is providing financial assistance to individuals, organizations and institutions for the relief of poverty. A charity must show through documented evidence and proper books and records that it undertook charitable activities in furtherance of charitable purposes and must demonstrate that it operated in compliance with the ITA at all times. This requires, among other things, an organization to show that the activities it undertakes benefit only proper objects of charity considering the relief offered. For instance, an organization relieving poverty must show that the beneficiaries of its programs in fact suffer from conditions associated with poverty. The poor are not simply the destitute, but anyone lacking essential amenities, i.e. food, shelter or clothing, available to the general population.

The Charity receives requests for financial assistance from various Canadian and international individuals, organizations and institutions. The individuals or representatives are to complete an application form which is reviewed by the Board of Directors. The Board of Directors approves the monetary distribution based on merit and the availability of funds. Funds are disbursed to aid recipients in the form of cheques. However documentation to acknowledge the recipients received the funds are not maintained.

Our audit revealed the Charity does not maintain or request the documentation necessary to prove the individuals are objects of charity nor does the Charity have defined selection criteria to establish financial need of the applicants. The application form used by the Charity requires the individual to provide their marital status, number of dependants, occupation, income and debts as well as the purpose of the application. The aforementioned form is acceptable. However without supporting documentation to substantiate the individual's level of income or lack thereof and defined selection criteria, we cannot ascertain the individuals are poor or that funding was provided to provide relief from the effects of poverty. The Charity has an obligation under the ITA of establishing that the individuals are in fact poor.

It is the responsibility of the Charity to obtain and to maintain adequate documentary evidence to clearly demonstrate recipients of its financial aid program were in fact poor and that the applications received were evaluated against an established set of criteria. By failing to show that it applied selection criteria in such a manner that the beneficiaries of its funding were in fact proper objects of charitable relief, the Charity cannot show that it meets the requirement of paragraph 149.1(1)(a) of the ITA.

Documentary evidence may consist of originals or copies of source documents such as salary confirmation letters, personal budgets, tax returns or bank statements. Other documentation should include minutes of Board of Directors meetings and other meetings held with applicants, Rabbis and community leaders; written selection criteria; evaluations, and approval or rejection of applications along with appropriate evidence showing the source documents supplied by the individuals; reports; summaries of follow-up visits undertaken (by the Charity's volunteers or directors) to evaluate application of the funds; telephone conversation records, faxes and/or e-mails of discussions of and decisions taken; and other relevant evidential materials or documentation.

The audit revealed applications for a variety of cases many of which did not indicate relief of poverty. A sample of the applications provided indicated the purpose for the application to be wedding assistance, fertility treatments, private debts, etc. These activities are not considered to be charitable as there is no public benefit inherent in assisting persons with weddings or personal debts. The activities are considered acts of private benevolence. The courts do not accept the act of private benevolence as charitable as it lacks the necessary element of public benefit.

Additionally, the audit revealed incomplete applications or missing applications and the applications did not contain information on approved by, approval date, amount approved, cheque # or the reason for approval (poverty, medical, housing or education).

The audit conducted for fiscal period ending December 31, 1995 indicated the Charity did not maintain adequate documentation to support the disbursement of funds. The only documentation the Charity maintained to substantiate the distribution of funds to individuals for the relief of poverty were cancelled cheques. The audit also revealed there was no documentation of the criteria used to select the beneficiaries, how the criteria were met in each case and the approval of the payments as Rabbi Lichter formerly conducted the needs assessment however this practise was discontinued. Our audit of fiscal periods December 31, 2003 and December 31, 2004 indicates the Charity continued to disburse funds to individuals for the relief of poverty without adequate supporting documentation.

Funds distributed without the necessary supporting documentation to prove that these funds were provided to needy individuals for the relief of poverty cannot be considered to be resources devoted to charitable programs. A charity may incur a disbursement quota shortfall if it does not expend eighty percent of the prior year's officially receipted donations less certain types of gifts received on charitable programs. When a charitable

organization fails to expend its disbursement quota in any taxation year, either on charitable activities carried on by it and by way of gifts made by it to qualified donees, the Minister may in the manner described in section 168 of the ITA revoke the charitable organization's registration.

Gifts:

It is our position that the cash donations received by the Charity from "donor" participants and the other participating charity are not valid gifts under section 118.1 of the ITA. We offer the following explanations to support our position.

No *Animus Donandi* - At law, a gift is a voluntary transfer of property without consideration. In most cases, a gift is a voluntary transfer of property without valuable consideration to the donor. An essential element of a gift is that there be intent to give. It must be clear that the donor intends to enrich the donee, by giving away property, and to grow poorer as a result of making the gift. It is our view, based on the transactions described above that the primary motivation of the donor was not to enrich the Charity, but through a series of transactions and a minimal monetary investment, to make a profit through the tax credits so obtained.

In support of this position, we note that the promotion materials primarily focus on the substantial return on investment as a result of the donor's participation. Minimal investment is required on the participant "donors". "Donors" received units of World Health Organization Essential Medicines from a trust and transferred ownership of the property to the Charity without using or seeing the property. The goods are typically transferred from the donors to the Charity within a few days of purchase or trust distribution. Minimal information is provided to the prospective "donors" as to how the "donations" will benefit the charity, or to the activities of the charity they are supporting. Transactions are pre-arranged and handled entirely by promoters or other pre-arranged third parties. Participants in these arrangements are merely expected to put forward a minimal investment to receive generous tax receipts in return. As such, it is our position that there is no intention to make a "gift" within the meaning assigned at 118.1 of the ITA. Participants in these donation arrangements are primarily motivated by the desire to profit from the manipulation of the tax incentives available from donations rather than a desire to enrich the participating charity.

Transfers not gifts - Additionally, we are of the opinion that the transactions themselves lack the necessary elements to be considered gifts at law. The "donors" received some form of consideration or benefit that was linked to their cash donations regardless if the cash donation was made to the Charity or another participating charity. The amount of the consideration or benefit received was directly linked to the amount of the cash donation made, therefore the transfer of the medicine units and cash payments are not valid gifts per section 118.1 of the ITA.

Cash payment - In our view, based on the above, we do not recognize the cash donations received as gifts made to the Charity. The amount represents a charge levied

by the tax shelter promoter to participate in the arrangement described above. While the gifts in kind were transferred to the Charity, it is clear this amount was not a voluntary transfer of property within the sense contemplated by the term "gift".

In support of this, we refer to the contract between the Charity and WHI whereby there is a clear link between the amount of cash received from the other participating charity and the amount paid to the promoter as fundraising fees. The fundraising fees paid represent 67% of the total cash gifts received from the other participating charity. While the Charity and the other participating charities received the cash donations, substantially all the donations were paid to the promoter and without the cash donations, the "donors" would not have become beneficiaries of the trusts.

Fair Market Value - Fair market value generally means the highest price, expressed in dollars, that a property would bring in an open and unrestricted market, between a willing buyer and a willing seller who are both knowledgeable, informed, and prudent, and who are acting independently of each other. The well-accepted definition of fair market value is found in the decision of Cattanach J. in *Henderson Estate & Bank of New York v M.N.R.* D.T.C 5471 at 5476:

The statute does not define the expression "fair market value", but the expression has been defined in many different ways depending generally on the subject matter, which the person seeking to define it had in mind. I do not think it necessary to attempt an exact definition of the expression as used in the statute other than to say that the words must be construed in accordance with the common understanding of them. That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the essential element, which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand. These definitions are equally applicable to "fair market value" and "market value" and it is doubtful if the use of the word "fair" adds anything to the words "market value".

As outlined by Rothstein, J.A. in *AG (Canada) v Tolley et al* 2005 FCA 386, in applying the Henderson definition of fair market value, the first step is to accurately define the asset whose fair market value is to be ascertained. Rothstein, J.A. discusses the relevance of donating a group of items versus an individual item and states that because the items were only acquired and donated in groups, the relevant asset was the group of items, and not the individual items in the group.

It is our position the conclusion made by Rothstein, J.A. also applies to the donation of medicine units. 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.

The second step in applying the Henderson definition is to identify the market in which the merchandise was traded. Rothstein, J. A. identifies this group of items might not be sold in the same market as individual items, and highlights this distinction through a comparison of the wholesale versus retail markets.

In *Klotz v The Queen* 2004 TCC 147, Bowman, A.C.J. stated "It is an interesting questions 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."

Based on our findings, the fair market value on the donation receipts issued is not indicative of the fair market value of the goods donated. The appraised value is based on suggested retail price. 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. The fair market value of the medicine units is the last known arm's length price paid for the goods.

Official Donation Receipts:

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 in the tax shelter were not valid gifts under section 118.1 of the ITA. Under the *Income Tax Act*, a registered charity can issue official donation receipts for income tax purposes for donations that legally qualify as gifts.
- Receipts issued to acknowledge goods received as a result of the Charity's participation the 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 thereby nullifying the fact that appraiser was independent and qualified to evaluate the particular property; and

- Each official donation receipt prepared by WHI on behalf of the Charity, acknowledging the units of pharmaceutical gifts in kind received failed to contain the phrase "*Official receipt for income tax purposes*" (Regulation 3501(1)).

Regulation 3501(4) of the ITA stipulates that an official receipt issued to replace an official receipt previously issued shall clearly show that it replaces the original receipt and, in addition to its own serial number, shall show the serial number of the receipt originally issued. Regulation 3501(5) requires that a spoiled official receipt form shall be marked "cancelled" and such form, together with the duplicate thereof, shall be retained by the registered organization or the other recipient of a gift as part of its records. The Charity retains copies of receipts, which were issued with incorrect information however the receipts are not marked "voided", or "cancelled".

The audit revealed that receipts issued by WHI, on behalf of the Charity, for replacement receipts were not prepared correctly. Receipts were provided containing a slash through the information. It is unclear if these receipts are considered spoiled or cancelled. Replacement receipts did not contain the phrase "this cancels and replaces receipt no. xxx" nor did the cancelled receipt mention "cancelled" on the Charity's copy.

The Charity issued official donation receipts for gifts received from other registered charities. Official donation receipts should not be issued to other registered charities to acknowledge gifts nor should other registered charities insist on receiving official donation receipts. Official donation receipts that bear a charity's registration number and other information required by the ITA are for tax deduction or credit purposes only. However a charity may issue receipts to acknowledge gifts it has received from other registered charities as long as those receipts are distinct from the official donation receipts.

An audit conducted for the fiscal period ending December 31, 1995 revealed the Charity issued official donation receipts without the statement "*Official receipt for income tax purposes*". The Charity undertook in its correspondence dated January 8, 1999 to ensure all receipts issued would be in accordance with all the Regulations under the ITA. The Charity has failed to implement the undertakings accepted by Revenue Canada (the Agency).

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.

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 T3010 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 T3010 for the fiscal periods ending December 31, 2003 to December 31, 2005 in that items reported were omitted. Specifically the following items:

FPE December 31, 2005 and December 31, 2004

- C9 indicated "No" whereas the Charity has contracted with WHI to conduct fundraising activities on behalf of the charity;
- Line 5450 – The gross revenues collected by the fundraisers should have been entered on this line;
- Line 5460 – The amounts paid to / retained by the fundraiser should have been entered on this line; and
- Line 5470 – The net fundraising revenue should have been included.
- T1235 Directors/Trustees Worksheet failed to contain the birth dates of the directors/trustees.

FPE December 31, 2003

- T1235 Directors/Trustees Worksheet failed to contain the birth dates of the directors/trustees.

Late Filing of T3010A Information Return:

Subsection 149.1(14) of the ITA requires every registered charity to file a T3010, **without notice or demand within six months from the end of each fiscal period.** This return must be in prescribed form and contain prescribed information.

The Charity was late in filing its T3010 returns over the following four consecutive fiscal years:

The Charity's Fiscal year end	Due Date	Date received
31-12-2005	30-06-2006	12-12-2006
31-12-2004	30-06-2005	23-12-2006
31-12-2003	30-06-2004	02-12-2004
31-12-2002	30-06-2003	12-11-2003

Remuneration and Benefits Reporting:

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.

No T4 / T4A slips were issued for remuneration paid to part-time employees employed by the Charity. The Charity reports two part-time employees receiving \$12,360 in 2005, \$12,250 in 2004 and \$18,100 in 2003.

Conclusion:

If you do not agree with the concerns outlined above, we invite you to submit your written representations **within 30 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. Should you choose not to respond, 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.

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

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

Sincerely,

Holly Brant
Audit Advisor
Charities Directorate
Charities Directorate
Canada Revenue Agency
320 Queen St. 7th Floor
Ottawa, Ontario K1A 0L5