Voluntary Sector Initiative
Joint Regulatory Table

Improving the Regulatory Environment for the Charitable Sector

Highlights

August 2002

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Introduction

Every day in Canada, volunteers and staff working in thousands of voluntary sector organizations are actively involved in making a difference in improving their communities.

Improving Canada's quality of life within healthy and economically strong communities requires a robust voluntary sector. A vibrant sector plays an important role in reinforcing social trust, social networks and common values. For many federal government departments, partnerships with the sector are essential to the fulfillment of their mandates and are a cornerstone to the delivery of programs and services.

The 1999 landmark document called *Working Together*[1] was a product of a joint policy exploration process undertaken by a group of voluntary sector leaders and senior government officials. This joint exercise, which has come to be known as the Joint Tables Process, delineated three distinct areas requiring strategic investment and attention:

- improving the relationship between the government and the sector,
- enhancing the capacity of the sector to serve Canadians, and
- improving the legislative and regulatory environment in which the sector operates.

To address the third area, a Joint Regulatory Table was formed in 2001. The mandate of the Table included research and recommendations in three key areas. In addition, the Table was asked to elaborate on the institutional models presented in *Working Together* and report on its findings by March 2003. A summary of the issues the Table is working on is provided below:

- **Lack of Transparency.** The current process for determining charitable status requires secrecy. As a result, the rationale behind decisions is not publicly known. The sector has expressed frustration at the lack of information to learn from previous decisions and at the perception of arbitrariness in decision-making.
- **Appeals.** Currently, appeals from the Charities Directorate of the Canada Customs and Revenue Agency (CCRA) are to the Federal Court of Appeal. This avenue is considered expensive, generating too few precedents to adequately guide the sector or the regulator.
- **Regulatory Sanctions.** The existing penalty for non-compliance is de-registration of a charity. This penalty is considered too severe to be appropriate except in the most extreme cases. A range of penalties commensurate with the level of violation could be considered.
- **Regulatory Institutions.** Canada's regulatory framework, including the institutional arrangement, seeks to balance the need to ensure public

[1] *Working Together: A Government of Canada/Voluntary Sector Joint Initiative*. 1999.

confidence in voluntary organizations, and the need to ensure a supportive and enabling environment for these organizations. There is a need to further develop potential institutional models to gain a better understanding of the implications of various approaches, their potential costs and benefits and the degree of support for a new institutional arrangement.

Through its deliberations, the Joint Regulatory Table has addressed each of these issues and has made interim recommendations. The highlights of these recommendations are contained in this report. The views presented are not necessarily those of all members of the Table.

The time has come to consult with Canadians and the voluntary sector about these proposed changes and on the various institutional models presented here. It should be stressed that these are tentative recommendations and the Table is open to reworking its recommendations based on the input it receives during consultations.

We will embark on cross-Canada consultations from September through November of 2002. We hope that you will actively engage in them. We want to hear your views on the issues raised in this report. Based on comments received, the Joint Regulatory Table will make its recommendations to government in March 2003.

Your opinion counts

To help focus the consultations, this report contains a series of highlight papers that each feature a number of discussion points.

To learn how you can provide comments and/or participate in the planned consultations, go to www.vsi-isbc.ca.

Each of the four issues contained in this report are discussed at greater length in a series of papers that are also available at the Website: www.vsi-isbc.ca or placing a collect call to 0-613-957-2926.

Accessibility & Transparency

Issue

The general public and organizations within the charitable sector must have confidence that the sector is being regulated effectively and efficiently and that sector members are operating openly and honestly. The public and sector members must have access to the regulatory policies and procedures of the regulator and there must be access to information about sector members. At the same time, it must be recognized that there is a need to exercise discretion when disclosing information.

Recommendations

To address the issues of accessibility and transparency, the Joint Regulatory Table has developed a series of recommendations concerning:

- documents related to charity applications;
- documents related to compliance actions taken by the regulator;
- documents on a charity's files that do not relate to either applying or complying; and
- general information not dealing with any organization.

Application documents

Before a decision has been made, all documents produced in relation to an application should be kept confidential.

The rationale for this includes the fact that individuals would not likely be able to give relevant information as to whether the applicant's proposed purposes are charitable or not. Also, procedural rules would have to be established to allow individuals to oppose registration and for applicants to examine the objection and submit additional material. This would result in a procedural logjam.

After a decision has been made, the regulator should release the reasons for the decision. Positive decisions do not need in-depth explanations. However, if an application is denied, the reasons should be more complete and include the organization's name and any appeal that is pending.

The release of this information is a critically important part of the transparency issue – detailing the policies and procedures of the Charities Directorate.

Compliance documents

Before a decision has been made, all documents produced in relation to a compliance action must be kept confidential.

To ensure that a charity complies with the law, the regulator must often audit the charity's books and records. The law enforcement aspect of the audit precludes the release of any internal or external documents prior to the audit's completion.

After a decision has been made, the regulator should be permitted to release the fact that the charity has been audited and whether a serious sanction has been imposed.

Releasing this information will help foster the public's trust in the sector.

However, the regulator should not release:

- the regulator's instructions to the auditor;
- information collected by the audit;
- internal memos and legal opinions;
- research materials; and
- negotiated settlements.

The fact that sanctions were imposed on the charity such as a financial penalty, suspension of qualified donee status or de-registration should be released.

Documents that do not relate to applying or complying

All information collected on the T3010 *Registered Charity Information Return* that is currently released should continue to be available to the general public.

The financial statements that each charity attaches to the T3010 should be accessible. The financial statements will provide a clearer understanding of how a charity operates. Also a charity's assets and liabilities status is important to anyone interested in supporting a particular charity. The necessary legislative changes should be made to enable this release.

Information related to the regulation of charities

Information concerning the policies and procedures of the regulator should be accessible to the public and members of the charitable sector. Information should be made available both in print and on the Internet.

Organizations need to be able to easily determine their responsibilities within the charitable sector, and the regulator needs to foster trust in its operations. The more information available the higher the resulting trust factor.

The regulator's Website should feature the following information:

- policies and procedures;
- a list of registered charities;
- a research database on court decisions;
- draft policies ready for consultation,
- pending legislative amendments; and
- an annual report on operations and service standards.

The regulator should publicize the contents of the Website and encourage public comment.

Discussion points

1. How important is confidentiality in a charity's dealings with the regulator?
2. With the exception of information shielded under information and privacy legislation, should all other information about a charity be open to public scrutiny?
3. Should the fact that an audit has been conducted be made public? Should the details of an audit be publicized? Should results be released when a charity is/is not cleared?
4. Do you agree that disclosure of CCRA policies and procedures and court precedents would improve accessibility and transparency?

Appeals

Issue

As currently constituted, the appeals regime within the charitable sector is slow, expensive and not easily accessed.

The *Income Tax Act* specifies that organizations must appeal to the Federal Court of Appeal if the Charities Directorate:

- denies their application for registration as a charity;
- takes away their registration; or
- gives them a designation (as a charitable organization, public foundation, or private foundation) with which they disagree.

No other mechanism exists to appeal regulatory decisions. This appeals process forces organizations to make many costly preparations including hiring counsel and preparing major documentation.

Recommendations

To reform the appeals process, the Joint Regulatory Table proposes reforms to the current appeals regime that involve the following elements:

- internal reconsideration within the original decision-making body;
- a hearing in the Tax Court; and
- an appeal on the record to the Federal Court of Appeal.

Internal reconsideration

Reconsideration involves the review of a compliance action at the administrative level – before judicial recourse.

The reconsideration would be chaired by a hearing officer who is part of the regulatory authority but who was not the original decision maker. Procedures would be informal, easily accessible and inexpensive.

Reconsideration should focus on (1) identifying any errors made at the initial decision-making stage and (2) listening to what an organization's representatives have to say. When a misunderstanding is the reason for the dispute, attempts would be made to resolve the dispute by determining whether the law has been correctly understood and applied. A hearing officer would be bound by the existing policies of the regulatory authority, but could report an apparent need for change to the head of the authority.

Reconsideration should be mandatory – that is, all disputes should be aired in an internal reconsideration prior to judicial recourse. However, an organization and the regulator can agree to bypass the reconsideration stage and go directly to court.

Role of the courts

This hearing would involve oral testimony and the ability to call witnesses before the court. There are three possible locations for a judicial hearing:

- a specially constituted tribunal to hear charity decisions;
- the Tax Court of Canada; and
- the Federal Court of Canada, Trial Division.

The Table believes the best location for this hearing would be the Tax Court. A new tribunal would not have to be constituted and the Trial Division of the Federal Court has little experience handling cases under the *Income Tax Act*. On the other hand, the Tax Court has the experience as well as the custom of handling cases in an informal manner. The informal nature of this court would increase accessibility.

Furthermore, the Tax Court is not bound by any legal or technical rules of evidence. Parties are not required to be represented by counsel.

The existing system, under which appeal from a Tax Court decision is filed with the Federal Court of Appeal, should be followed.

Intervenors

We suggest that the current rules established by the court provide adequate opportunity for interested parties, including members of the voluntary sector, to present their views in significant cases.

Costs

Regular cost rules should apply at the Tax Court level. After a hearing, the Tax Court will determine whether to award costs and at what level. For appeals from the Tax Court to the Federal Court of Appeal, and from the Federal Court of Appeal to the Supreme Court, the court will determine the costs. It will also determine if costs should be awarded against an organization when it appeals and loses.

Subsidization

Where appropriate, expenses for developing and presenting an appeal could be subsidized. Intervenors could also receive funding where their intervention would assist the court in developing the law. Subsidization would make the appeals regime more accessible to many charities.

Factors affecting reform

In creating the appeals reform recommendations, the following factors were considered:

- transparency of the proceedings to the organization, the voluntary sector, and the general public;
- correctness of the decision, including consistency in the decision-making;
- independence of the adjudicator;
- prompt resolution of disputes;
- accessibility, in terms of location, procedures, and costs to the organization;
- creation of precedents for the guidance of the regulatory authority and the sector;
- creation of a complete evidentiary record; and
- cost to government of establishing and maintaining the appeals system, including not duplicating existing mechanisms for review that could be readily adapted to handle charity cases.

Discussion points

1. Would it be useful (a) to have an internal administrative process, and (b) to require organizations seeking recourse to first use the process, despite the fact that the process would be confidential and

conducted within the regulatory authority?

2. As the first external court level, do you favour the Tax Court of Canada, the Federal Court Trial Division, or the existing Federal Court of Appeal?
3. If there was a funding mechanism to help bring legally significant cases before the court and therefore obtain more precedents to guide the sector and the regulatory authority, who should decide which cases merit funding – the regulatory authority, a sector advisory body, or an arm's length body?
4. Is there any value to including in the recourse system a specialized tribunal (perhaps including members from the charitable sector)? Such a tribunal might be knowledgeable about the sector, but its decisions would not be binding in the way a court's decisions are.

Intermediate Sanctions

Issue

The main penalty for non-compliance is de-registration of a charity. This penalty is considered too severe to be appropriate except in the most extreme cases. A range of compliance actions appropriate to the infraction should be considered.

Recommendations

The purpose of a sanctions regime is to obtain compliance with the law. To develop a more rational approach to compliance, the Joint Regulatory Table has developed a proposed series of compliance actions that range from minimal impact to very severe impact on the charities involved – Tier 1 through Tier 4.

These recommendations were developed with the assumption that most charities want to meet their legal requirements. Therefore, the need for the regulatory authority to work with charities to inform them of the law and to develop solutions to problems as they occur is emphasized. The focus is on remediation – on putting things right.

Tier 1

Tier 1 involves giving a charity the information or advice it needs to meet its legal requirements. Charities must know and understand what is expected of them. The regulator needs to:

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

Tier 2

Tier 2 involves negotiating a settlement with a non-compliant charity guilty of an infraction. In this case, the charity and the regulatory authority would consider the charity's specific circumstances and work out together how a problem can be resolved.

In the case of charities that do not file their annual returns, the regulator would publish the names of non-compliant charities, eliciting public pressure on the charity to ensure compliance.

Tier 3

This level of compliance action involves more serious sanctions. Here charities face the possibility of:

- the suspension of qualified donee status (the charity could no longer issue tax receipts for gifts or receive grants from charitable foundations);
- a financial penalty on the charity (the charity would lose its tax-exemption, with tax payable being up to 5% of previous year's income, or up to 10% for repeated infractions); or
- a financial penalty on individuals (this involves individuals connected to a

charity who would pay a tax equal to the private benefit obtained, plus 25%).

Tier 4

The compliance action at this level would be de-registration of the charity. Also, the existing revocation tax would be replaced to ensure that the assets of a charity are applied for charitable purposes.

Factors affecting the recommendations

The Table considered a number of factors when developing the four-tier sanctions regime. These factors included:

- compliance vs. sanctions (compliance behaviour is not shaped only by potential sanctions);
- matching the sanction to the non-compliance (the sanction must be appropriate to the act of non-compliance);
- choosing who should impose the penalty;
- deciding whether detailed sanctions can or should be spelled out in legislation;
- deciding what type of sanctions are appropriate;
- an accessible and timely appeal mechanism and the ability to stay a penalty pending appeal;
- ensuring that the compliance program is transparent and reassuring the public that an effective regulatory regime is in place;
- deciding whether to maintain the power to de-register a charity;
- delineating the roles of the federal and provincial governments in facilitating and monitoring charities; and
- deciding how to deal with evidence of non-compliance under statutes other than the *Income Tax Act*.

Discussion points

1. The Table has emphasized that organizations need to understand the legal requirements for registration. What can the government and the sector do to educate charities?
2. Do you agree that intermediate sanctions should be introduced? Should de-registration remain for extreme cases of non-compliance?
3. If de-registration remains for extreme cases, should the revocation tax be replaced?
4. What about the various intermediate sanctions proposed? Would they be effective? Are they appropriate? What type of situations, if any, would justify financial penalties on individuals?
5. Should a registration requirement be introduced to prevent those who have abused the system from serving in a position of influence in another charity?
6. Should the regulatory authority have considerable discretion in selecting an appropriate sanction, provided the sanction is delayed while the organization appeals the decision?

Institutional Reform

Issue

Canada's federal regulatory framework for charities, including the institutional arrangement, seeks to balance the need to ensure public confidence in voluntary organizations, and the need to ensure a supportive and enabling environment for these organizations. There is a need to further develop potential institutional models to gain a better understanding of the implications of various approaches, their potential advantages and disadvantages and the degree of support for new institutional arrangements.

In response to this need, the Joint Regulatory Table has developed four institutional models for public discussion. We have not yet endorsed any one model -- our mandate is to elaborate on the models presented in *Working Together* through research and consultation, not select a preferred option.

In addition to the three models described in *Working Together*, we have identified a fourth, hybrid model.

Because of Canada's Constitution, some of these models may pose issues that are not easily overcome. For that reason, the Charities Commission model described cannot be an exact duplicate of the Charity Commission for England and Wales. Appendix 2 of the Table's Interim Report discusses this matter in further detail.

In examining institutional reform, our objective is to have a regulator that is recognized and respected by charities, stakeholders and the Canadian public for its integrity, fairness, knowledge and innovative service delivery. The result of reform should be client-oriented service and improved compliance.

We believe the role of the regulator under each of the models presented is to administer the *Income Tax Act* provisions that pertain to charities. We have also identified the following four core values, which we believe the regulator should embody.

- Integrity – have a high level of expertise and an impartial, transparent and fair decision-making process.
- Openness – encourage the exchange of ideas and promote communication with the sector and the public.
- Quality service – committed to delivering quality services to its clients.
- Knowledge and innovation – be forward looking and in step with society's needs and expectations.

If the regulator is to be effective in fulfilling its mandate, a number of critical success factors must be met.

- Support – the regulator must ensure that the regulated have the information and understanding they require to comply with the law.
- Profile/Visibility of the regulator – the public must be assured that a regulator is supervising the activities of the regulated to ensure compliance with applicable laws.

- Resources – the regulator must have access to the physical, financial, human and technological resources necessary to be effective.
- Location of the regulator – there are advantages and disadvantages to having the regulator sit within or outside an existing government department. These must be assessed, along with whom the regulator reports to, when considering the implications of the various models.
- Legal principles and powers to determine charitable status – the regulator does not have the power to change the law beyond the flexibility that is implied in the decisions of the courts. The regulator can, however, draw analogies that the court would draw to purposes that have already been recognized as charitable. This capacity to find and develop analogies needs to be enhanced.
- Co-ordinated regulation – the regulation of charities is shared between the federal, provincial, and territorial governments. There may be benefits to exploring opportunities to develop a better co-ordinated system of regulation.

There are a number of administrative mechanisms through which existing concerns could be addressed. They include:

- Public consultation – to allow the regulator to identify new trends, to provide input into its interpretation of the law on charitable status, to contribute to knowledge about the sector and to gather information.
- Annual reporting – to communicate with stakeholders on the regulator's activities and performance.
- Ministerial advisory group – to advise the Minister on improving the policy framework.
- Professional development – to increase staff retention and enhance their competence in interpreting the law regarding charitable status.

Summary of proposed models

The four models that we have developed range from an enhanced version of the current model within the CCRA to a new regulatory entity outside the CCRA.

The four models we examined include:

- Model 1 – an enhanced CCRA that proposes improvements to the existing Charities Directorate within the CCRA, including changes the Table is proposing related to accessibility and transparency, sanctions and a new appeals mechanism.
- Model 2 – an enhancement of the current arrangement with an added advisory agency similar to the "agency" model described in *Working Together*.
- Model 3 – a combination of Model 1 and Model 4 that would leave some administrative functions in the CCRA but create a Charity Commission to register charities and apply the new compliance program.
- Model 4 – a Charity Commission that would assume all regulatory functions currently performed by the CCRA.

Discussion points

1. Are the institutional models described accurately?
2. Have any implications of the models been missed or misstated?
3. Do you agree that the mandate of the regulator, wherever it sits, is to administer the provisions of the *Income Tax Act*?
4. What core values should guide the regulator?
5. What critical success factors need to be met for the regulator to effectively fulfil its mandate?
6. How could trust in charities and trust in the regulator be enhanced?
7. How should complaints from the public about charities be handled?
8. How could a better co-ordinated system of regulation be developed and supported.