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3) Failure to Maintain Adequate Books and Records

Subsection 230(2) of the Act requires that every registered charity maintain adequate books and records, and books of account, at an address in Canada recorded with the Minister. In addition to a duplicate of every official donation receipt and the supporting documents for each such donation, subsection 230(2) also requires adequate records to be kept to allow CRA to determine whether there are sufficient grounds for revocation of the charity's registration. Furthermore, subsection 230(4) provides that "Every person required by this section to keep records and books of account shall retain

- (a) the records and books of account referred to in this section in respect of which a period is prescribed, together with every account and voucher necessary to verify the information contained therein, for such period as is prescribed; and
- (b) all other records and books of account referred to in this section, together with every account and voucher necessary to verify the information contained therein, until the expiration of six years from the end of the last taxation year to which the records and books of account relate."

The policy of the CRA relating to the maintenance of books and records, and books of account, is based on several judicial determinations, which have held that:

- it is the responsibility of the registered charity to prove that its charitable status should not be revoked⁴;
- a registered charity must maintain, and make available to the CRA at the time of an audit, meaningful books and records, regardless of its size or resources. It is not sufficient to supply the required documentation and records subsequent thereto⁵; and
- the failure to maintain proper books, records and records of account in accordance with the requirements of the Act is itself sufficient reason to revoke an organization's charitable status⁶.

It is our view that the Organization failed to provide access to all of its records at the time of the audit review or subsequent to the audit review as follows:

- The Organization issued a \$30,000,000 official receipt for 30,000 Class B non-voting shares (██████████ shares) in the capital stock of ██████████ but did not provide documentation to support the valuation of the shares. Under section 3501 of the *Income Tax Act Regulation*, a qualified donee is required to report the fair market

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⁶ *(College Rabbiniq de Montreal Oir Hachaim D'Tash v. Canada (Minister of the Customs and Revenue Agency)*, (2004) FCA 101; Act subsection 168(1)



CANADA REVENUE
AGENCY

AGENCE DU REVENU
DU CANADA

Association for the Advancement of Scholarship

REGISTERED MAIL

Attention:

July 3, 2012

BN: 88741 7806 RR0001
File #: 3023700

Subject: Audit of Association for the Advancement of Scholarship

Dear

This letter is further to the audit of the books and records of Association for the Advancement of Scholarship (the Organization) conducted by the Canada Revenue Agency (the CRA). The audit related to the operations of the Organization for the period from May 1, 2005 to April 30, 2009.

The CRA has identified specific areas of non-compliance with the provisions of the *Income Tax Act* and/or its *Regulations* in the following areas:

AREAS OF NON-COMPLIANCE:		
		Reference
1.	Failure to Devote All of Its Resources to its Charitable Activities	149.1(1) 168(1)(b)
2.	Failure to meet its Disbursement Quota	149.1(2)(b)
3.	Failure to maintain adequate books and records	168(1)(e) 230(2)
4.	Failure to file a T3010A <i>Registered Charity Information Return</i> as required by the Act.	149.1(14) 168(1)(c)

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 Organization 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 Act and common law applicable to registered charities. If these provisions are not complied with, the Minister of National Revenue (the Minister) may revoke the Organization's registration in the manner prescribed in section 168 of the Act.

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

680-1

1) Failure to Devote all of its Resources to Charitable Purposes

Charitable Purposes and Activities

In order for an organization to be recognized as a charity, it must be constituted exclusively for charitable purposes, and devote its resources to charitable activities in furtherance thereof.¹ In the Supreme Court decision of *Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.* [1999] 1 S.C.R. 10, Lacobucci J. speaking for the majority, summarized the requirements for charitable registration at paragraph 159, as follows:

"In conclusion, on the basis of the Canadian jurisprudence, the requirements for registration under s. 248(1) come down to two:

- (1) the purposes of the organization must be charitable, and must define the scope of the activities engaged in by the organization; and*
- (2) all of the organization's resources must be devoted to these activities."*

The term "charitable" is not defined in the Act; therefore it is necessary to rely on the jurisprudence in the common law. The courts have recognized four general categories of charitable purposes: (1) the relief of poverty; (2) the advancement of religion; (3) the advancement of education; and (4) other purposes beneficial to the community as a whole (or a sufficient section thereof) in a way that the law regards as charitable. This last category identifies an additional group of purposes that have been held charitable at law rather than qualifying any and all purposes that provide a public benefit as charitable.

With regard to the devotion of resources, in accordance with the provisions of the Act, a registered charity may only properly use its resources (funds, personnel and/or property) in two ways, both inside and outside Canada – for charitable activities undertaken by the charity itself, under its continued supervision, direction and control, and for gifting to "qualified donees" as defined in the Act.

A charity must be able to show through documented evidence and proper books and records that it undertook charitable activities in furtherance of its charitable purposes. 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.

The Organization was registered as a charitable organization effective May 26, 2003 to

- award scholarships, fellowships, bursaries and prizes to persons, based upon either, or both, financial need and scholastic excellence, for the advancement of education;

¹ *Vancouver Society of Immigrant & Visible Minority Women v. Minister of National Revenue*, [1999] 1 S.C.R. 10, at page 110 (paragraph 152, 154, 156)

- develop, fund, administer, promote and carry on activities and programs as well as fund and supply equipment, supplies and facilities to advance the theory, practice and delivery of education in order to cultivate and develop the potential, knowledge, skills and abilities of individuals;
- develop, fund, administer, promote and carry on activities, programs and facilities that will develop compassionate humanitarian assistance, relief, care, treatment, education and training to relieve poverty and suffering and improve the quality of life for needy persons and improve economic and health conditions in poor communities;
- receive gifts, bequests, trusts, funds and property and beneficially, or as a trustee or agent, to hold, invest, develop, manage, administer and distribute funds and property for the objects of the Corporation, for and to such other organizations as are "qualified donees" under the provisions of the *Income Tax Act* and for such other purposes and activities as are authorized for registered charities under the provisions of the *Income Tax Act*; and
- conduct any and all activities and exercise any and all such powers as are necessary for the achievement and furtherance of the objects of the Corporation.

Based on our findings as illustrated below, it appears the Organization has failed to demonstrate that it devotes its resources exclusively for its charitable purposes.

a) Gifting to Non-qualified Donees

X Prize Foundation (XPF)

In 2006, the Organization signed an agreement with XPF, a non-profit organization registered under 501(c)(3) of the Internal Revenue Code in California, U.S. A main program ("XP program") of XPF is to encourage private groups to compete for large prizes in exchange for solving some very difficult problems in areas such as medicine and space travel.

The stated intent of the agreement was to implement the XP program in Canada. This objective was to be achieved as follows: the Organization would purchase certain licensing rights and intellectual property from XPF required to implement the XP program and later transfer such rights to a newly registered charity, X Prize Canada, once the latter obtained registered charitable status in Canada. The Organization transferred the first instalment of \$3 million U.S.² to XPF with the promise that \$410,655 U.S. would be paid by December 1, 2007 and a further \$1.5 million U.S. by December 1, 2008.

[REDACTED] As a result of [REDACTED] the Organization terminated the agreement with XPF and no further payments were made. However, the earlier payments were not returned to the Organization, and it did not appear that the Organization obtained any licensing rights or intellectual property in consideration of those payments. This was confirmed by [REDACTED] legal counsel for the

² Total cost \$3,372,300 CAD; \$324,000 in currency exchange difference and \$48,300 paid to [REDACTED] Inc. for services rendered regarding this transaction.

³

Organization, who advised CRA that no benefit, either charitable or non-charitable, was received by the Organization. [REDACTED] stated that he considers the funds transferred to X Prize to be a gift made to a qualified donee.

To meet the definition of charitable organization under the Act, the Organization must devote all its resources for charitable activities undertaken by itself or an agent that is under its direction and control, and for gifting to qualified donees. Based on the facts outlined above, the \$3 million US transferred to XPF by the Organization was not used in any charitable activities carried on by the Organization. Further, XPF did not fit the definition of a qualified donee under subsection 149.1(1) of the Act. Since the Organization did not receive any property of value in return, we consider the \$3 million US transferred to XPF to be a gift to a non-qualified donee.

Ashdown School

Our audit also indicated that the Organization had distributed \$90,000 in scholarships, fellowships, bursaries or prizes to The Ashdown School in the United Kingdom. It did not appear that the recipient of these funds was acting as an agent for the Organization, nor was it a qualified donee as defined in the Act. For the same reasons specified above, it is our position that the Organization had failed to devote its resources exclusively to charitable activities carried on by itself.

b) Due Diligence of Directors

Directors of a not-for-profit corporation are fiduciaries and generally subject to the same common law fiduciary obligations as directors of a business corporation. A fiduciary is a person having legal duty to act primarily for another person's benefit and is a person who (a) owes another person the duties of good faith, trust, confidence, and candor; and (b) must exercise a high standard of care in managing another's property. As a general matter, fiduciary duties are imposed by the law to protect those who are vulnerable from those who have power over them. Being a fiduciary means the directors will be held to high standards of good faith, fair dealing and loyalty regarding the organization. The duties of the directors of a charity include decision making, investing charitable property, performing corporate governance and the active management and protection of charitable assets. The fiduciary duties of the directors go beyond meeting the charitable objects of the charity, and the interests of the charity should be put ahead of the interest of the directors. The definition of a charitable organization under subsection 149.1(1) of the Act also implies a charity's assets are to be managed so as to obtain the best return within the bounds of prudent investment principles.

We note with concern that the directors of the Organization have demonstrated a lack of due diligence in safeguarding its assets and ensuring that its resources are used exclusively for charitable purposes. It is our position that the Organization's directors used the Organization to engage in transactions that did not further its charitable purposes but rather confer undue benefits on other organizations and individuals that were not qualified donees. More importantly, these transactions resulted in significant erosions of the Organization's

financial resources with no tangible benefit to the Organization and have put its charitable status at risk.

X Prize Foundation (XPF)

As per above, the Organization entered into an agreement to acquire certain intangible property from XPF. While the proposed transaction, if completed, represented a cost exceeding \$4 million US to the Organization, our audit did not show that the directors took any steps to confirm the existence and fair market value of the intangible property to be acquired. Furthermore, although the completion of the transactions as proposed in the agreement was contingent on the charitable registration of X Prize Canada under the Act, there was no provision in the agreement that would allow the Organization to either receive a refund of the payments already made or receive property of equal value in case of X Prize Canada's failure to obtain registered charitable status. In other words, the directors allowed the Organization to enter into an agreement that implied it could forego as much as \$4 million US of funds to a non-qualified donee without receiving anything of value in return. Ultimately, the Organization did forego \$3 million US paid to XPF as a gift to a non-qualified donee when X Prize Canada failed to obtain charitable status under the Act.

In summary, the directors allowed the Organization to enter into an agreement with XPF where there is no reasonable assurance that the Organization would receive due benefits for the substantial amounts of resources transferred to XPF. In the end, the Organization disbursed \$3 million US on a transaction that neither benefited itself nor furthered its charitable purposes. It is therefore our position that the directors failed to fulfill their fiduciary duties to safeguard the Organization's assets and to ensure such assets were used exclusively in accordance with its bylaws, constitutions, and charitable objects.

Archon Shares

The Organization purchased 2.9 million common shares of Archon Minerals Ltd. (Archon Shares) that were trading at \$3.25/share on the Canadian Venture Exchange (CVE) at the time, from Quest University Canada Foundation (QUCF) for a total consideration of \$9,425,000. In April 2009, the Organization disposed of the Archon Shares at \$0.81/share, for total consideration of \$2,632,500, resulting in a loss to the Organization's investment of \$7,947,500 or 46% of the Organization's net assets. Our audit revealed that shares were sold to the same person who had previously donated them to QUCF.

Our review showed that the Archon shares, although listed on the CVE, were thinly traded and closely held by the original donor to QUCF. As such, the Archon shares represented a risky investment for the Organization, and the share price as quoted on the CVE at any given time does not necessarily represent their fair market value. However, our audit did not show that the directors of the Organization obtained an independent appraisal of the value of the Archon shares or considered the risks of investing in such shares. In the end, the transaction resulted in a \$7.9 million detriment in the resources of the Organization and may have conferred a significant benefit on the original donor.

It is our position that the directors of the Organization had failed to fulfill their fiduciary duties of, at the very least, ensuring the prudent investment of the Organization's assets.

Conclusion

Our audit indicated that the Organization had made significant gifts to persons that were not qualified donees, as well as engaging in transactions that resulted in significant losses of its financial resources without benefitting itself or furthering its charitable purposes. It is therefore our position that the Organization failed to devote its resources exclusively to charitable activities carried on by itself as was required under 149.1(1) of the Act. As such, there appears to be sufficient grounds to revoke the charitable registration of the Organization under paragraph 168(1)(a) of the Act.

2) Disbursement Quota Shortfall

Pursuant to paragraph 149.1 (2)(b) of the Act, a charitable organization's registration may be revoked if it fails to expend amounts on charitable activities and gifts to qualified donees that are at least equal to its disbursement quota in a taxation year. For the Organization's taxation years under audit, the disbursement quota of each year as defined under subsection 149.1(1) of the Act includes an amount equal to 80% of the Organization's total tax-receipted gifts in the preceding year.

Although the 2010 Federal Budget and its accompanying legislation has proposed significant changes to the charitable expenditure part of the disbursement quota (80/20 part A), it does not apply to fiscal years ending before March 4, 2010.

Based on the *Registered Charity Information Returns* as filed, the Organization had accumulated a significant shortfall in spending on charitable activities and qualified donees needed to meet its disbursement quotas over the audit period. The shortfall becomes more pronounced after factoring in the following audit adjustments:

Fiscal Period Ending in	Available for Carry-Forward	Shortfall (Excess)
2006	37,825	37,825
2007	15,049,088	15,086,913
2008	625,707	15,712,620
2009	-143,814	\$15,568,806

The large shortfall in 2007 (\$15,049,088) is as a result of the \$30,000,000 donation receipt issued in 2006 and the disallowance of \$3,324,000 paid to XPF, a non-qualified donee. The books and records provided during the audit did not provide documentation to verify the donation was to be treated as enduring property. The *Registered Charity Information Return* incorrectly reported the amount paid to XPF as a charitable expenditure.

There appears to be sufficient grounds to revoke the charitable registration of the Organization, as it has failed to meet its disbursement quota obligation as per paragraph 149.1(2)(b) for the taxation years under audit.

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It is our view that the Organization failed to provide access to all of its records at the time of the audit review or subsequent to the audit review as follows:

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⁶ *(College Rabbiniq de Montreal Oir Hachaim D'Tash v. Canada (Minister of the Customs and Revenue Agency)*, (2004) FCA 101; Act subsection 168(1)

value of the gift on the official receipt.

- The Organization sold 27,500 of the [REDACTED] shares for a "Misery Pipes" royalty interest that was reported at a value of \$27,500,000. The Organization did not provide documents supporting the valuation of the royalty interest.
- The Organization paid \$2,000,000 to Quest University Canada for the naming rights of some buildings on the university's campus but was unable to provide documentation to support the valuation of the naming rights.
- The Organization paid expenses on behalf of Quest University Canada for executive directorship and leadership in the 2008/2009 academic year. The invoices totaled \$324,000 but showed little or no detail of the services provided. [REDACTED] in his letter of May 10, 2010 indicated that it would be very time consuming to provide a detailed description of services to date and the details of the dynamic nature of executive directorship is well-understood by individuals who take on this responsibility. However, the Organization would not be able to support that these expenses were incurred in the course of carrying out its charitable activities without sufficient documentation.

Conclusion

It is our view that the Organization failed to maintain adequate books and records and to provide complete access to its records for our inspection at the time of the audit review. As such, it is our position that there is sufficient grounds to revoke the registration of the Organization under paragraph 168(1)(e) of the Act.

4) Failure to File an Information Return as Required by the Act

Pursuant to subsection 149.1(14) of the Act, every registered charity must, within six months from the end of the charity's fiscal year end, file a *Registered Charity Information Return* (T3010A) with the applicable schedules, containing information as prescribed by the CRA.

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 requirements to file an Information Return if it fails to exercise due care with respect to ensuring the accuracy thereof.

The Organization has improperly completed T3010A returns for the May 1, 2005 to April 30, 2009 fiscal periods as follows:

Fiscal years 2006 to 2009

- Payments received pertaining to the "Misery Pipes" royalty interest are shown as a reduction in the value of the royalty interest reported on line 4140 of the T3010A. The royalty income received should have been reported as "Other Revenue" on line 4650.

Fiscal year 2006

- F4 – The Organization reported \$15,000,000 in tax-receipted gifts of enduring property for the fiscal period. However, our audit of the Organization's records did not show any tax-receipted gifts received would be considered an enduring property as defined in subsection 149.1(1) of the Act.

Additionally, our records showed that the Organization had consistently failed to file its returns on time as illustrated below:

<u>FPE</u>	<u>Due Date</u>	<u>Received</u>
2010-04-30	2010-10-31	2011-01-17
2009-04-30	2009-10-31	2009-12-07
2008-04-30	2008-10-31	2008-12-22
2007-04-30	2007-10-31	2007-12-27
2006-04-30	2006-10-31	2006-12-07

It is therefore our position that the Organization had failed to file its information returns as required by the Act. As such, there appears to be sufficient grounds to revoke the registration of the Organization under paragraph 168(1)(c) of the Act.

The Organization's Options:

a) No Response

If you choose not to respond, please advise us in writing of your intent. In that case, the Director General of the Charities Directorate may give notice of its intention to revoke the registration of the Organization by issuing a Notice of Intention in the manner described in subsection 168(1) of the Act.

b) Response

Should you choose to respond, please provide your written representations and any additional information regarding the findings outlined above **within 30 days** from the date of this letter. After considering the representations submitted by the Organization, the Director General of the Charities Directorate will decide on the appropriate course of action, which may include:


- no compliance action necessary;
- the issuance of an educational letter;
- resolving these issues through the implementation of a Compliance Agreement; or
- the Minister giving notice of its intention to revoke the registration of the Organization by issuing a Notice of Intention in the manner described in subsection 168(1) of the Act.

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.

2.5.07

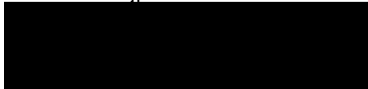
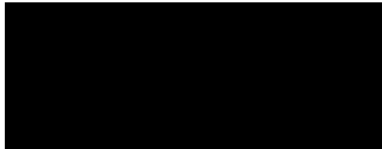
If you have any questions or require further information or clarification, please do not hesitate to contact the undersigned at the numbers indicated below.

Yours sincerely,

A black rectangular redaction box covering the signature of the undersigned.

Jeanne Effler,
Audit Division
Telephone (250) 363-0276
Facsimile (250) 363-3862

cc: Christopher Richardson

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