



Canada Revenue
Agency

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du Canada

REGISTERED MAIL

March 18, 2010

The Gateway Benevolent Society
Suite 200, 2296 McCallum Road
Abbotsford, BC V2S 3P4

BN: 89427 1618RR0001
File #: 3015152

Attention: Mr. Ian Worland

Subject: Audit of The Gateway Benevolent Society

Dear Mr. Worland:

I am writing further to our letter dated January 21, 2009 (copy enclosed), in which you were invited to submit representations as to why the Minister of National Revenue (the Minister) should not revoke the registration of The Gateway Benevolent Society (the Organization) in accordance with subsection 168(1) of the *Income Tax Act* (the Act).

We have now reviewed and considered your response on behalf of the Organization dated February 19, 2009. Notwithstanding your reply, our concerns with respect to the Organization's failure to devote all of its resources to its charitable purposes, failure to issue receipts in accordance with the Act and/or its Regulations, acquisition of control of a corporation, and failure to maintain adequate records have not been alleviated. The basis for our concerns is explained below.

Failure to Operate for and Devote its Resources to Charitable Purposes

As you are aware, the Organization was registered July 31, 2000 as a public foundation. The Organization's stated purposes, as contained in its governing document are

Vancouver Island Tax Services
1415 Vancouver Street
Victoria BC

Mailing Address:
Vancouver Island Tax Services
c/o 9755 King George Hwy.
Surrey, BC V3T 5E1

Services fiscaux de l'Île de Vancouver
1415, rue Vancouver
Victoria, C-B

l'adresse postale :
Services fiscaux de l'Île de Vancouver,
A/S 9755 Aut. King George
Surrey, C-B V3T 5E1

Canada

[t]o provide financial and other forms of assistance for low income families and individuals in the Fraser Valley region of British Columbia in the following ways:

- (a) by subsidizing education for job training;
- (b) by operating a benevolent funds [sic] directly through other registered charities;
- (c) by assisting in financing Christian education; and
- (d) educating on Christian stewardship.

In 2004 the Organization was re-designated, on request, as a public foundation.

As detailed in our previous letter, our audit reviewed the Organization's operations of November 1, 2003 to October 31, 2007 and the audit demonstrated that, during the period under review, little of the activities fall within the charitable purposes of the Organization. While we acknowledge that the Act includes, as a statutorily recognized charitable purpose, gifting to qualified donees, we also note that:

- (1) the Organization is not established for this general purpose – being instead established for the narrower purpose of providing financial and other forms of assistance to low income persons, and
- (2) the preponderance of financial and other activity during the period under review was not directed towards the achievement of the Organization's purposes, but instead towards the benefit of private individuals.

As stated in our previous letter, the Organization has primarily operated for the private benefit of private individuals and corporations, each seeking to dispose of their farm assets. In our view, the transactions were designed to route the property through registered charities under the guise of legitimate investments and gifts to facilitate the avoidance of taxes payable on the disposition of these assets, rather than to genuinely enrich the charities involved. The Organization's role in three of the arrangements was to purchase the shares of the corporation. When the assets of the corporation were sold to another corporation or gifted to another participating charity, the shares of the corporation were written down to nil at year-end.¹

Your letter of February 19, 2009 states that the transactions entered into by the Organization were done "for the purpose, and achieve the result, of securing funds for use in its charitable activities." With respect, we disagree. While it is clear that the Organization realised some benefit from the transactions, it is our view that the primary purpose of these transactions was to benefit private individuals and their corporations with incidental benefits being received by the Organization (and sometimes to the detriment of charitable funds). Specifically we note the following:

¹ Refer to Appendix A, B and C outlining the series of transactions entered into by the Organization, the actions taken by the Organization and the resulting profit earned for its role in the arrangements.

Fiscal Year 2004:

Your response characterizes this transaction as a net benefit of \$170,000 to the Organization. In our view, this overlooks the fact that, having purchased 100% of the shares in _____, it was, in our view, already entitled to the assets in _____ including the gain. Rather than simply receiving the full amount as a dividend, an artificial donation was made from _____ of property already owned by the Organization. A \$455,000 tax receipt was subsequently issued for a net benefit to the Organization of \$170,000.

Fiscal year 2005:

As outlined in our previous letter, in 2005 the Organization entered into a number of transactions, along with three other Canadian registered charities, to facilitate the sale of farm assets of a corporation, including its BC egg hatching quota. In our view, the transactions were designed to route the property through the participating registered charities under the guise of investments and gifts, to facilitate the avoidance of taxes otherwise payable on the disposition of these assets, rather than to genuinely enrich the charities involved. The Organization's role in the arrangement was to receive funds from another registered charity and to use those funds to purchase the shares of the corporation. The Organization did in fact purchase these shares in full knowledge that the assets of the corporation were to be gifted to another participating charity causing its investments to be de-valued to nil. For its part in the arrangement, the Organization received \$50,000.

In your letter you note that the net financial benefit to the Organization was \$50,000. With respect, we disagree with this characterization. In our view, as a registered charity the Organization was obligated to devote the full \$720,250 towards its charitable purposes (i.e., the provision of financial assistance to low income individuals). The purchase and pre-planned write-down of \$670,250 in shares is simply an unacceptable use of assets which should have been devoted to genuine charitable ends.

Regarding the _____ transactions, as described in our previous letter, the Organization also entered into a number of transactions, along with three other Canadian registered charities, to facilitate another sale of farm assets of a corporation, including its BC egg hatching quota. The transactions, as above, also involved the Organization's purchase of \$1,154,440 of shares from _____ and the pre-planned write-down of the shares to nil.

In your letter you note that the transaction produced a net benefit of \$11,000 for the Organization. Again, we disagree with this characterization. While the Organization,

after the transactions in question, may have received a nominal fee, it also issued a substantial tax receipt for a gift purportedly received but was left with no equivalent increase in assets.

As in our previous letter, we note that the Organization purchased, on credit, 35% of the shares in [redacted] for \$1,142,890 in full knowledge that these shares, as a part of this scheme, would be de-valued to zero. These shares were in fact devalued to zero when 35% of the assets of [redacted] - assets which the Organization already beneficially owned - were gifted to the Organization (and a tax receipt of \$1,154,440 was issued). After the pre-arranged sale of the properties and repayment of the loans, the Organization was left with little more than a small fee for participation. As such, solely based on the nature of transactions as represented to us, in the [redacted] arrangement it appears that the Organization improperly disposed of \$1,142,890 to purchase shares it knew would subsequently become valueless.

In 2007, the Organization received \$1,800,000 from [redacted] and issued a charitable tax receipt. In your letter you note that "the gift was not used to acquire shares of [redacted] but rather that Malachi already owned those shares." You are correct that the Malachi 3:10 Foundation did, in fact, already own the shares in [redacted] - 100% in fact. As such, it would appear that the Organization has structured its operations to flow money through its accounts and issue a receipt for a donation of property effectively already owned by another registered charity. *Per* the details outlined in our previous letter, this was done to artificially create a donation to registered charities where, in fact, the shares owned by a registered charity were being devalued to zero. The Organization's role in this transaction was to accommodate the parties involved by transferring the funds donated to it to the Malachi 3:10 Foundation.

As above, our view is that in the years under review, the Organization has not operated for exclusively charitable purposes, but has primarily operated for the benefit of private individuals. In your letter you note that, during the years in question, the Organization raised over \$231,500² for use in its charitable programs and distributed over \$400,000 to unrelated qualified donees. We respectfully disagree with this characterization as, in our view, the operations of the Organization clearly demonstrate that the Organization was operated for private tax planning purposes with its charitable purposes merely being incidental.

Between 2004 and 2005 the Organization's primary activity was participation in tax abusive planning arrangements and, during that period, it received a net benefit of \$231,500 for its participation. In that same period the Organization issued tax receipts for \$1,609,440, purchased and wrote-off \$1,813,140 in investments in private companies,

² According to your representation letter, the Organization netted \$170,000 from the [redacted] Inc; \$50,000 from the [redacted]; and \$11,550 from the [redacted] transactions.

and incurred \$101,077 in legal and consulting fees. The Organization expended a mere \$80,194 on gifts to qualified donees during that period.

While, in 2006 the amount of charitable activity increased to \$427,949, we note that the largest single gift made (\$250,000) was to a non-arm's length charity, the Malachi 3:10 Foundation, the participant in the 2007 transactions. Again, in 2007, we see substantially all of the Organization's activity devoted to participation in a tax planning arrangement with a mere \$54,000 being gifted to arm's length qualified donees and \$21,691 in professional and consulting fees.

As described above, and as detailed in our previous letter, in our view the overall conduct of the Organization in the arrangements demonstrates that the Organization is operating for the purpose of promoting private interests in personal tax planning arrangements, rather than operating in furtherance of its charitable purposes. As mentioned in our previous letter, the Organization paid for various other expenses incurred by the corporations involved in the tax planning arrangements. During the audit period, the Organization paid over \$143,000 for legal and consulting fees related to these transactions, and \$41,000 to the CRA for taxes owing on behalf of one of the corporations and for other expenditures such as appraisal and property searches for transactions that, in our view, were primarily designed to benefit private individuals.

For these reasons we remain of the position that the Organization has failed to pursue its charitable purposes, failed to operate for exclusively charitable purposes as required by subsection 149.1(1) of the Act and has operated for the private gain of the individuals and corporations involved in the tax planning arrangements. As such the Organization has failed to demonstrate that it meets the test for continued registration under 149.1(1) as a charitable foundation "operated exclusively for charitable purposes".

Gifts to Non-Qualified Donees

In your letter you characterize the transactions as expenditures incurred towards fundraising. As above, it is our view that the majority of transactions were primarily designed to benefit private individuals and their corporations with an incidental benefit to the Organization (and arguably a net loss to the sector if one considers charitable funds lost through the deliberate write-down of investments). In our view, the Organization has paid for legal advice and fees on behalf of private individuals and as such there are grounds for its revocation under this Act.

In addition, it is our view that, in the transactions described above, the Organization has made a gift to a non-qualified donee by transferring \$670,250 in return for a small participation fee and shares that it knew were valueless at the time or were about to become valueless. We do not view this transaction as a simple purchase of an investment by the Organization as the devaluation of the shares was pre-planned. As such, we are of the view that the transfer of the funds was a gift to a non-qualified donee

other than in accordance with the Act and in violation of its mandate that it operate for exclusively charitable purposes.

In the same fashion, it is our view that the Organization knew, or ought to have known that in the transactions, the purchase of \$1,142,890 of shares, on credit, were valueless at the time or were about to become valueless. The Organization therefore made an additional gift to a non-qualified donee.

Issuing Receipts Not in Accordance with the Act

Our position remains that the assets received by the Organization from [redacted] and [redacted] were not valid gifts under section 118.1 of the Act.

It is our contention that, as above, the primary motivation of the corporations was not to enrich the Organization, but through a series of structured transactions, route the sale of assets through several registered charities with the sole objective to avoid or reduce the taxes otherwise payable on the disposition of assets. Transactions were structured to give the appearance of a gift for the purpose of obtaining an official donation receipt, whereas little or no benefits were obtained by the registered charities.³

It remains our view that the Organization, in the majority of the transactions described above, did not have discretion to use the assets received towards its charitable programs but was obligated to disburse these as directed. As such, it is our position the Organization was not entitled to issue official donation receipts in these circumstances.

Further, it does not appear that the gift of assets from [redacted] and [redacted] did not qualify as a gift at law as the transfer of assets was not legally effective. The purchase and sale agreements to sell the assets to third parties were entered into prior to the Organization's involvement. As stated in our previous letter, the Organization at no point gained unfettered ownership of the assets. In fact, the [redacted] legal representative confirmed to the BC Chicken Marketing Board that the ownership remained in the hands of Mr. and Mrs. [redacted] "despite any change in ownership and control of the Company [redacted] which may have taken place". Also, as outlined in our previous letter, the [redacted] re-acquired some of the same assets (excluding the permit and quotas held with the BC Chicken Marketing Board and BC Egg Hatching Commission) previously "donated" to the Organization and purchased the shares from the participating charities for \$1⁴. The assets did not change in value. It is in this regard that the CRA is unconvinced the corporations involved "ended up poorer" as a result of the transactions

³ In the case of [redacted], \$1,800,000 was "donated" to the Organization who in turn issued a donation receipt and immediately transferred the funds to a related charity, Malachi 3:10 Foundation for the purpose of repaying the debt it incurred acquiring EII's shares.

⁴ May 26, 2005 - Organization purchases shares of [redacted]; May 30, 2005 - [redacted] gifts assets to Organization; May 31, 2005 Organization sells quotas to third party, assets and shares to the [redacted]

entered into with the Organization. The corporations succeeded in their pre-arranged sale of assets and/or quotas while obtaining official donation receipts to offset any capital gains or taxes accruing as a result of the sales.

We accept the Organization's representations and documentation provided regarding receipts #6002, 4001, 4002 and 4003.

Acquiring Control of a Corporation

We concur with your argument that the Act does not specifically require the Minister to revoke the registration of a public foundation that has acquired control of a corporation. However, as previously stated in our letter of January 21, 2009, paragraph 149.1(3)(c) of the Act permits the Minister to revoke the registration of a public foundation that has, since June 1, 1950, acquired control of a corporation. Additionally, Charities Summary Policy CSP-C28 states "Charitable foundations cannot acquire control of any corporation. Control usually means that the foundation owns, or the foundation plus persons not dealing with it at arm's length own, more than 50% of a corporation's issued share capital with full voting rights."

Despite the Organization's representations that the acquisition occurred five years ago and that there has not been a subsequent acquisition of control, we do not agree that the Organization should not be revoked. The timing of the acquisition has no bearing on our decision; the fact remains that the Organization acquired control and retains control of the corporation to date. Additionally, we note that on March 17, 2005, the Organization entered into another "Contract of Purchase and Sale of Shares" to purchase all of the shares in the capital of [redacted]. Although the audit did not reveal any evidence to show that this sale did occur, no evidence has been provided indicating the contract was cancelled.

Failure to Maintain Adequate Records & Registered Charity Information Return

Our position remains that the Organization failed to maintain and/or provide its books and records. A registered charity must maintain, and make available to the CRA at the time of the audit, meaningful books and records, regardless of its size or resources. The Organization was provided sufficient time to prepare and provide its books and records prior to and during the course of our audit yet chose not to make all of its records available.

Our position remains that, for all of the reasons outlined in our letter of January 21, 2009, the Organization did not maintain adequate books and records. The representations received did not alter our position.

We accept the Organization's representations that the errors and omissions on the Registered Charity Information Returns (T3010) are not grounds for revocation; however, our position remains that the Organization failed to file complete and accurate T3010s.

Appropriateness of Revocation

Finally, we note that your letter argues, "In our view, many of the allegations set out in your letter are unfounded." We disagree. As discussed above, the Organization has failed to demonstrate that it operates exclusively for charitable purposes. Instead, the Organization operates to facilitate the benefits of individuals and corporations involved in tax planning arrangements and have lent its status and tax-receipting privileges to support these personal interests. The Organization has acquired over \$3.3 million in shares and assets yet has deliberately written-off \$1,813,140 in investments and devoted only 20% or \$690,000⁵ to charitable activities. The Organization has also breached a number of other requirements of the Act as described above. It is the CRA's position that these breaches are serious contraventions of the Act and likely warrant the revocation of the Organization's registered status.

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 A/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 A/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

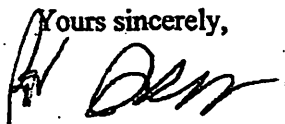
⁵ Included is a gift of \$250,000 made to another charity participating in the tax planning arrangements.

- 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.

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,



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

Attachments:

- Our letter dated January 21, 2009
- Your letter dated February 18, 2009
- Appendix "A", Summary of
- Appendix "B", Summary of
- Appendix "C", Summary of

Ltd.

Transactions

cc: Mr. John Glazema