How to Structure and Begin Charitable Operations in Canada

Any effective operation will have to begin with creation of a Canadian “registered charity.”

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It is not unusual for a tax-exempt organization in the U.S. at some time to consider operations in Canada, either because donors who are residents of Canada require charitable receipts that can be used for taxation purposes in Canada or because of a strategic plan to expand charitable activities into Canada. In either situation, the legal advisor for a U.S. tax-exempt organization will often be asked to provide an explanation of what is involved in establishing charitable operations in Canada.

Not every tax-exempt organization in the U.S. would qualify to become a “registered charity” (discussed below) in Canada. Only those U.S. organizations that meet the requirements of what is considered by the Canadian courts to be “charitable at law” (also discussed below) would be able to become Canadian registered charities.

It is for that reason that this article is directed at commencing “charitable operations” in Canada instead of establishing a “tax-exempt organization” in Canada.

This article is the first of two designed to provide attorneys, as well as senior executive staff members of U.S. tax-exempt organizations, with a practical outline of the various issues to be addressed and steps to be taken in commencing charitable operations in Canada, preferably as part of implementing an overall structure for international operations. This installment provides an overview of the Canadian law governing registered charities and their relationships with counterparts in other countries. The second portion, which will appear in an upcoming issue of The Journal of Taxation of Exempt Organizations, will describe structures for international operations that fit within the requirements of Canadian law.

**REGISTERED CHARITIES**

The first issue is why a U.S. tax-exempt organization would not simply carry on operations itself in Canada. While there is nothing to stop it from doing so, a U.S. tax-exempt organization would not be entitled to receive the tax and other advantages that are available only to a registered charity in Canada. The advantages of being a registered charity (also referred to below as a “Canadian charity”) are:

- Canadians who make donations to a U.S. tax-exempt organization cannot use charitable receipts issued by the U.S. organization for income tax purposes in Canada, except when applying the receipted amount against income earned in the U.S., or when a Canadian taxpayer lives near the Canada-U.S. border throughout the tax year and is employed or carries on business in the U.S. A Canadian registered charity, however, can issue charitable donation receipts that can be used as tax credits by donors who are residents of Canada.

- A registered charity is exempt from paying income tax in Canada.

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A registered charity is entitled to receive a partial refund of the Goods and Services Tax (GST) that is imposed under the Excise Tax Act for goods and services acquired by the Canadian charity.\(^5\)

There is a psychological advantage in raising money from donors in Canada if the organization raising the money is Canadian, as opposed to one that is a U.S. or other "foreign" organization.

Given the significant advantages of being a Canadian registered charity, it is important to understand what is required to become one.

Requirements for registered charity status. For an organization to become a registered charity in Canada under the Income Tax Act (ITA), certain basic requirements must be met. Those requirements are set out under sections 248(1) and 149.1(1) of the ITA and are explained in Information Circular 80-10R, “Registered Charities: Operating a Registered Charity,”\(^6\) as well as in a recent draft publication issued by Revenue Canada entitled “Registered Charities: Operating Outside of Canada.”\(^7\) The requirements are:

1. The organization must be created or established in Canada.
2. The organization must be resident in Canada. This is generally understood to mean that a majority of its directors or trustees must be Canadian residents.
3. The purposes and activities of the organization must be charitable at law.
4. The organization must apply for registration and be designated by Revenue Canada as a charitable organization, a public foundation, or a private foundation. A "charitable organization" is loosely characterized by Revenue Canada as an "initiator of charitable activities as distinct from an organization which funds the activities of others."\(^8\) A "public foundation" is generally described by Revenue Canada as "constituting a public body that is formed for the purpose of funding the charitable activities of other registered organizations." A "private foundation" is a foundation that is not a "public foundation" for one of two reasons—either 50% or more of its directors, trustees, officers, or similar officials of the foundation do not deal with each other at arm's length; or more than 50% of the capital contributed or otherwise paid to the foundation is paid by one person or by a group of persons who do not deal with each other at arm's length.
5. The organization must devote all of its resources to charitable activities carried on by the organization itself if it is a charitable organization, or it must be constituted and operated exclusively for charitable purposes if it is either a public foundation or a private foundation.
6. The organization must ensure that no part of its income is payable to, or is otherwise available for the personal benefit of, any of its members, proprietors, trustees, or directors.
7. The organization must expend its resources on its own charitable activities and ensure that the transfer or gift of funds to other organizations is limited to organizations that are identified in the ITA as "qualified donees" (defined below).
8. The organization must control and direct the use of its own funds and resources.
9. The organization must spend a certain amount of money each year on charitable activities to meet a prescribed minimum "disbursement quota" under the ITA. The disbursement quota is generally equal to 80% of the donations for which receipts were given during the previous tax year, subject to certain exceptions. If the charity is either a public foundation or a private

\(^1\) As this is an overview, the discussion is necessarily general (and the citations therein have been kept to a minimum). Thus, specific legal advice should be obtained in Canada before a definitive legal opinion is given to a U.S. client.
\(^3\) Income Tax Act (ITA), Revised Statutes of Canada, 1985 (RSC), c. 1 (5th Supp.), subsection 118.1(9).
\(^4\) ITA subsection 110.1 permits a tax credit against income for the fair market value of all gifts given to registered charities. Subsection 118.1(2) requires that a receipt containing certain prescribed information be given to claim such gifts.
\(^7\) Revenue Canada Draft Publication RC4106F, “Registered Charities: Operating Outside Of Canada,” Revenue Canada Charities Division, Ottawa, Ontario.
\(^8\) Note 6, supra, at 2.
\(^9\) Id.
ability to establish a customized organizational structure without the intrusion of governmental review or requirements.

A charitable unincorporated association does not, however, provide limited liability protection for its members. This can be of concern if the association faces the risk of legal action due to injuries or even claims for sexual or child abuse. As such, the unincorporated association is not the preferred legal form through which charitable operations are carried out in Canada.

Charitable trust. A charitable trust requires a written trust agreement signed by a settlor or settlors appointing one or more individuals to act as trustees of certain charitable property pursuant to a clearly delineated statement of charitable purposes. The advantage of the charitable trust is that it is relatively easy to create and avoids the formalities associated with incorporation. The difficulty with a charitable trust, though, is that it generally requires the appointment of successive trustees. The exception is the religious organization that can rely on provincial legislation to provide for perpetual trustees notwithstanding that successive trustees have not been appointed on a continuous basis.  

In addition, trustees may be exposed to potential liability on a personal basis. As such, unless the charity operates as a passive public or private foundation only, with little or no exposure to legal risk or liability, it is generally recommended that a charitable trust not be used.

Charitable not-for-profit corporation. A charitable not-for-profit corporation without share capital can be incorporated federally under the Canada Corporations Act, or under provincial incorporating legislation in each province, such as the Ontario Corporations Act. The advantage of using a not-for-profit corporation to carry on charitable operations in Canada is the permanency of the corporate vehicle as well as the limited liability protection that it affords to its members. As a result, most organizations that carry on active charitable operations in Canada are organized as charitable not-for-profit corporations.

Generally speaking, it is preferable to incorporate federally under the Canada Corporations Act. Doing so makes it easier to carry on operations across Canada because extra provincial registrations in each province can be obtained without having to have the corporate name of the charity approved on a province-by-province basis.

BECOMING A REGISTERED CHARITY

Becoming a registered charity in Canada normally takes between eight to 12 months, although that time frame can vary considerably. The process involves the steps described below.

Assuming that the organization is being structured as a charitable not-for-profit corporation, an application for letters patent would be made to either the federal government, through Industry Canada, or provincially through one of the provincial ministries of corporate affairs, such as the Ministry of Consumer and Commercial Relations in Ontario. If the application is made to the federal government, Industry Canada will normally grant letters patent of incorporation within two weeks of receiving an application, with the effective date for the letters patent being the date that the application is received. On the other hand, if the application for incorporation is made to the provincial government, the time involved can vary considerably. In Ontario, for example, an application for incorporation must first be approved by the Attorney General through the Office of the Public Guardian and Trustee, which can add a month or more to the application process. This unwanted delay and resulting additional scrutiny of the application is the reason that most not-for-profit charitable corporations located in Ontario apply for incorporation federally under the Canada Corporations Act.

Once letters patent are issued, an application to have the corporation become a registered charity is made to the Charities Division. This involves submitting the following documentation to Revenue Canada.

- An application on form T2050 for income tax registration of Canadian charities.
- A certified copy of the letters patent for the corporation as well as a certified copy of its general operating by-law.
- A statement of activities explaining how the corpora-

foundation, it must also expend at least 4.5% of any assets it owned over the previous 24 months that were not used directly in charitable activities or in the administration of the foundation, less any amount calculated in its 80% disbursement quota.10

10. The organization must maintain sufficient books and records in Canada to satisfy the requirements of Revenue Canada, enabling the department to verify that the funds of the charity have been properly spent and that the charity retains control and direction over the use of its resources.11

The most difficult of these requirements is to satisfy Revenue Canada that the purposes and activities of the applicant are exclusively charitable at law.

What is "charitable at law?" Although the ITA defines the requirements to become a registered charity, it does not define what a "charity" is or what is meant by "charitable," notwithstanding the fact that Revenue Canada must be satisfied that all of the purposes and activities of the applicant are charitable at law before charitable registration can be given. Applicable case law has generally held that a purpose will be considered "charitable" if it is one that is directed to any one of the following purposes.12

- The relief of poverty.
- The advancement of education.
- The advancement of religion.
- Other purposes benefiting the community as a whole as determined by the courts.

The Charities Division of Revenue Canada will scrutinize an organization applying for registration to determine whether or not the purposes stated in its constating documents are exclusively charitable and whether or not its activities as proposed in its "statement of activities" will be undertaken exclusively in fulfillment of those charitable purposes.

In this regard, there are a number of important restrictions imposed by the Charities Division concerning what a registered charity can and cannot do. Some of the more important restrictions that must be complied with are as follows:

- The charitable purposes and activities must not violate Canadian public policy as interpreted by the Charities Division.
- A registered charity must not engage in political activities that exceed the restrictions established under the ITA as interpreted by the Charities Division and the courts.13
- A registered charity must not generate revenue through unrelated business activities, although there are certain limited business activities that can be carried out by a registered charity if it fulfills the requirements of a "related business activity" under the ITA.14

Forms of organization. A registered charity that is designated as a "charitable organization" by the Charities Division can be structured as a charitable unincorporated association, a charitable trust, or a charitable not-for-profit corporation. A public or private foundation must be either a charitable trust or a charitable not-for-profit corporation.

Charitable unincorporated association. A charitable unincorporated association is technically not a separate legal entity at common law in Canada.15 Rather, it is considered to be a collection of individuals who have agreed, either explicitly or by implication, to work together in a quasi-contractual relationship as an association to pursue a stated charitable purpose. A charitable unincorporated association is particularly attractive for churches and small charitable organizations because of the ease with which it can be created, the lack of formalities in operation, and the

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11 See Information Circular 78-10R3, 10/5/98, Revenue Canada Charities Division, Ottawa, Ontario.
13 See ITA section 149.1, subsections (1)-(1), (6)-(1), and (6)-(2). See also Information Circular 87-1, "Registered Charities—
14 See ITA section 149.1(1), which defines a "related business" to include a "business that is unrelated to the objects of the charity if substantially all persons employed by the charity in the carrying on of that business are not remunerated for that employment." This definition in effect provides permission for a registered charity to operate an unrelated business provided that it is substantially operated by volunteers.
tion intends to fulfill its charitable purposes.
- A certified copy of the names of the directors of the corporation and its officers.
- A proposed financial statement for the first year of the corporation's operations.

An alternative procedure would be to submit draft incorporation documentation to the Charities Division, along with draft copies of the documents required to apply for charitable status, and request that the Charities Division grant pre-approval before proceeding with formal incorporation. This procedure would avoid having to amend the charitable purposes in the letters patent if they were found to be deficient by the Charities Division. An amendment of the charitable purposes would otherwise require an application for supplementary letters patent, which can produce a time-consuming delay. The pre-approval process can involve a significant time factor itself, however, since the draft documentation must be approved twice—once during the draft approval process and a second time in its final form after the incorporation has been granted. Most charitable clients are interested in obtaining status as a registered charity as quickly as possible. Therefore, they will normally prefer to incorporate first and then apply for charitable status, effective as of the date of incorporation, notwithstanding the risk of possibly having to apply for supplementary letters patent.

Normally, seven to ten months will pass from the time that the Charities Division receives the application to become a registered charity until the application is finally approved. The process can, however, be expedited if there is an emergency. Alternatively, the application could be delayed for a considerable period if it was found to be deficient because the Charities Division found that either the purpose or the activities of the applicant were not exclusively charitable at law.

Assuming that charitable status is granted by Revenue Canada, the determination will normally be retroactively effective from the date on which the organization was created. That will be the date on which letters patent were issued to a charitable not-for-profit corporation, or the date of the trust agreement that formed a charitable trust. A registered charity will only be able to issue charitable receipts for donations received on or after the effective date of its grant of charitable status.

In the process of granting charitable status, the Charities Division will designate the applicant as a "charitable organization," a "public foundation," or a "private foundation," depending on what designation the applicant has requested and the opinion of the Charities Division concerning whether the applicant meets the statutory definition of the requested designation.

While the application of a not-for-profit charitable corporation is being reviewed by Revenue Canada, the solicitor for the applicant will arrange to have the initial organizing resolutions for the corporation prepared. The solicitor will also prepare and forward to the board of directors a report explaining their responsibilities, duties, and liabilities in operating a charitable corporation in Canada.

Once an applicant becomes a Canadian registered charity, it will be required to keep its records and books of account at an address in Canada. Information Circular 80-10R states that all "registered charities" must have available for inspection sufficient records to allow verification of the donation receipts issued, income received, and any disbursements made. The circular explains what records are to be kept, where and how they are to be kept (including electronic records), and how long they are to be kept.

Within six months of the end of its fiscal year, the organization must file a Registered Charity Information Return on a prescribed form, currently form T3010. The information required on that return is very detailed and includes questions about the affiliation of a registered charity with organizations located outside of Canada, as well as details of any funds that are transferred outside of Canada.

CHARITABLE ACTIVITIES

Once an organization has been designated as a Canadian registered charity, it must ensure that all expenditures of its funds and resources are used for charitable activities in fulfillment of its charitable purposes. This involves the registered charity carrying out such activities itself or alternatively transferring money or property to a qualified donee as defined in the ITA. The definition of "qualified donee" includes other registered charities, but even then such

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19 ITA section 230 (2).
20 Supra, note 6 at paragraph 25. See also Information Circular 78-10R3, supra note 11.
21 ITA section 110.1, subsections (1)(a) and (b). Besides registered charities, the ITA definition includes a wide variety of donees. These include, among others, (1) a Canadian governmental entity, (2) a not-for-profit housing corporation resident in Canada, (3) a university located outside of Canada that is prescribed to be a university and has a student body that ordinarily includes students from Canada, and (4) a charitable organization located outside of Canada to which the government of Canada has made a gift during the tax year or in the 12 months preceding the tax year.
payments generally may not exceed 50% of the receipted income from the previous year.

Revenue Canada will generally treat certain activities as carried out by the charity itself. These include activities undertaken:

- By employees of the charity.
- By volunteers of the charity.
- By agents of the charity.
- Pursuant to a charitable joint venture in which the charity and a foreign charity participate.
- By a charitable partnership in which the charity and the foreign charity participate as partners.

It is not acceptable to Revenue Canada for a Canadian registered charity to make payments to its U.S. counterpart though a gift of funds or resources. The reason is that a U.S. tax-exempt organization is not a qualified donee unless it has been included in the list of prescribed universities under the ITA. Thus, payments to a U.S. tax-exempt organization by a Canadian registered charity are possible only if the payment or transfer constitutes a charitable activity that is carried out by the charity itself.

**ACCEPTABLE PAYMENTS TO U.S. COUNTERPARTS**

Until the Charity Division’s June 1998 release of the draft publication “Registered Charities: Operating Outside of Canada,” there was considerable uncertainty concerning what Revenue Canada would find acceptable in the way of payments by a Canadian registered charity to organizations located outside of Canada that were not qualified donees. Although the draft publication has not yet been formally adopted by Revenue Canada, it is considered to be a relatively accurate statement of the Charity Division’s current position on this issue.

The draft publication sets out general guidelines concerning how a Canadian registered charity can make payments outside of Canada, whether it be to a U.S. tax-exempt organization or to another non-Canadian charity.

**Payment methods.** A Canadian registered charity can generally make a payment outside of Canada to its U.S. counterpart if the payment is made:

- Pursuant to a contract to acquire goods or services, such as the purchase by the Canadian charity of books published by a U.S. organization.
- Pursuant to an agency agreement as discussed below.
- Pursuant to a joint venture agreement as discussed below.
- Pursuant to a co-operative partnership agreement as discussed below.
- In accordance with a permitted expenditure for international membership fees as discussed below.

**Terms of agreement.** If a payment by a Canadian registered charity is made to a U.S. organization pursuant to an agency agreement, joint venture agreement, or co-operative partnership agreement, the Charities Division requires that there be certain basic provisions contained within the agreement. In brief, they are:

- The agreement must be in writing and must be for the primary purpose of furthering the charitable purposes of the Canadian charity.
- The agreement must provide that the Canadian charity is to provide periodic and specific instructions concerning the application of its funds.
- The Canadian charity must regularly monitor the payments made with respect to a project or program being undertaken pursuant to the agreement.
- The agreement must require that there be regular written progress reports given to the charity.
- The Canadian charity must have the right to inspect the applicable project or program being undertaken.
- Adequate records must be maintained at the address of the Canadian charity in Canada.

**Agency.** An agency agreement would be appropriate if money from a Canadian registered charity is transferred to a U.S. tax-exempt organization for a specific program or project. Under an agency agreement, the U.S. organization would be formally appointed as the agent of the Canadian charity to disburse certain designated funds on behalf of the Canadian charity. In addition to the general requirements already outlined above, Revenue Canada also requires that the following additional provisions be included in an agency agreement:

- The agent—i.e., the U.S. organization—must hold the funds that it receives from the Canadian charity segregated from its own funds.
- The U.S. organization, as agent, must keep separate books and records concerning the receipt and expenditure of agency funds that are received and disbursed.

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22 Note 7, supra.
23 Id.
**Joint ventures.** A joint venture agreement would be appropriate if the Canadian charity is transferring money to a U.S. organization to carry on programs or projects on an ongoing basis and both the Canadian charity and the U.S. organization are participating, even if the level of contribution from each organization is unequal. For example, joint venture agreements are often used if a Canadian missionary organization participates in funding ongoing foreign missionary activities with a U.S. organization.

If a joint venture agreement is used, Revenue Canada requires that there be ongoing control exercised by the Canadian charity in relation to its contribution to the joint venture. Indicia of what Revenue Canada considers to be acceptable evidence of ongoing control includes:

- **The presence of Canadians on the governing body of the joint venture in numbers proportionate to the monetary contributions made by the Canadian charity.**
- **The physical presence of Canadians at the project or in running the joint venture program.**
- **The input of Canadians into the hiring and firing of personal involved with the joint venture.**
- **The input of Canadians into the initiation and follow-through of the project or the joint venture program.**
- **The requirement for Canadian signatures on contracts and agreements involved with the joint venture.**
- **The ongoing review by the Canadian charity of the budget and financial statements of the joint venture.**
- **Canadian authorship of manuals, standards, guidelines, and materials used in operating the joint venture.**
- **The identification of the project or program as a joint venture involving the Canadian charity.**

**Partnerships.** A co-operative partnership agreement would be appropriate if the Canadian charity is entering into a partnership arrangement with a U.S. organization. The agreement would have to have each party carrying out a particular aspect of an international charitable project or program or contributing specific resources, equipment, or other property for such project or program.

**Royalties.** Revenue Canada will permit payments to a U.S. organization, or to others that are not qualified donees, as royalty payments, license fees, or international membership fees. Such payments would, however, have to be equal to the lesser of (1) 5% of the total expenditures of the Canadian charity in that year or (2) C$5,000. If payments exceed the permitted amount, the Canadian charity will have to produce written documentation that the excess fees paid were no more than the fair market value of the goods and services that were received by the U.S. organization.

**Conclusion**

Although there are many similarities between the law in the United States in dealing with tax-exempt organizations and the law in Canada dealing with “registered charities,” there are considerable differences as well. These differences require careful planning and analysis in actually structuring a cross-border operation, as will be described in the next installment.