Choosing a Form of Organization for Operations in Canada

The key is autonomy within a set of mutually acceptable restrictions.

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It is not unusual for a tax-exempt organization in the U.S. at some time to consider commencing operations in Canada, preferably as part of implementing an overall structure for international operations. Practically speaking, this will require creating a Canadian “registered charity” to secure the tax advantages this entails under Canadian law. These advantages, the requirements for becoming a registered charity, and other aspects of Canadian law covering charitable operations were discussed in a previous article. The following discussion covers structures for international operations that fit within the requirements of Canadian law.

AN INTERNATIONAL STRUCTURE FOR CANADIAN OPERATIONS

In establishing a Canadian registered charity to work in conjunction with a U.S. tax-exempt organization, it is essential to recognize that the Canadian charity is an independent and autonomous legal entity that cannot be owned as a subsidiary of the U.S. organization (or for that matter, any other foreign organization). This autonomy and the inability of a non-share capital corporation to be owned through a “parent/subsidiary” arrangement means that the establishment of an international structure in which the Canadian charity is a part must be carefully planned and implemented. This is often accomplished using a contractual arrangement between the Canadian charity and the U.S. organization, requiring that the internal structure for the Canadian charity reflect a particular pre-approved general form.

Frequently, though, a U.S. tax-exempt organization that operates in more than one country will not have developed a clear organizational structure to carry on its operations on a worldwide basis. This omission often occurs because the founding U.S. organization operates as both a domestic organization in the U.S. as well as the overseeing body for international charitable operations. This dichotomy in roles can cause confusion, misunderstanding, and even mistrust by the charities of the other countries, including Canada. It fosters a perception, justified or not, that the founding U.S. organization is acting as a “benevolent dictator” over international operations. This, in turn, can lead to resentment and tension with domestic charities in other countries in which the U.S. organization carries on operations.

Before commencing charitable operations in Canada, it is therefore important to understand the possible models of an international structure and how the Canadian registered charity fits into them.

There are three types of international charitable structures that are commonly used.

International co-operative model.

With this model, each country establishes a separate domestic charitable corporation. Each domestic charity has full control over ownership of its corporate name and associated trademarks in its own country. All domestic

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Charities work in conjunction with each other on a consensual basis according to a loose international association that may or may not be reduced to writing. Even when an association agreement is in writing it is normally not intended to be in a form of an enforceable arrangement. The international co-operative model is illustrated in Exhibit I, above.

The difficulty with this model is that if one domestic charity no longer complies with the agreed-on international standards, there is little if anything that the other domestic charities—including the founding U.S. organization—can do to stop the renegade domestic charity from breaking rank in its own country.

**International Subsidiary Model.** In this model, the founding U.S. charity functions as the international parent organization as well as a U.S. tax-exempt organization. It co-ordinates the activities of charities in other countries, including Canada. The international subsidiary model is illustrated in Exhibit II on page 154.

As mentioned above, this dual role puts the founding charity in a delicate position. The charity can too easily tend to dominate, not only the international operations, but to a certain extent the internal operations of each non-U.S. charity as well. This control is often manifested by a board of directors of the local charity being dominated by board members who are either U.S. board members or are nominees of the U.S. organization. Even if there were local board members on the board of the U.S. parent organization, that participation would frequently be limited to a nominal or token participation only. The lack of reciprocity in board membership often leads to frustration and resentment by members of the board of directors of the local charity.

**International Umbrella Model.** In this model, each country has its own domestic charity, including the U.S., notwithstanding that the U.S. organization is the founding charity. A separate charitable corporation is then incorporated in one country, normally the U.S., to act as the international umbrella organization to establish, co-ordinate, and enforce international standards for charitable operations for all domestic charities, including the U.S. domestic charity. The international charity normally owns the applicable trademarks in each country and licenses those trademarks to each domestic charity under a license or other contractual arrangements. The international charity is controlled by a board of directors elected on a proportionate basis by all participating domestic charities, including the U.S. domestic charity. The international charity would not control the activities of domestic charities in their own countries, however, other than to ensure that the international standards that have been agreed upon by all domestic charities are adhered to. The international umbrella model is illustrated in Exhibit III on page 155.

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2 For a more complete discussion of the issues involving the establishment of an effective international charitable structure, see Carter, “National and International Charitable Structures: Achieving Protection and Control,” Fit to Be Tithed 2: Reducing Risks for Charities and Not-for-profit (Department of Continuing Legal Education, Law Society of Upper Canada; 1999),
CANADIAN OPERATIONS—THE FRANCHISE MODEL

No matter which international charitable structure is adopted, it is essential that careful consideration be given to establishing and implementing effective control provisions by the U.S. organization concerning certain fundamental aspects of Canadian operations. In this regard, failure to document the relationship between the U.S. organization and the Canadian charity properly could result in a disagreement between the two organizations, with the Canadian charity asserting that it is the owner of its name, trademarks, and associated goodwill in Canada. Although a dispute of such issues would likely be resolved through negotiations or mediation, the potential for costly legal action with the resulting damage to the reputation of both organizations could be significant and must therefore be avoided at all costs. To do this, the relationship between and the expectations of both organizations must be clearly stated at the time that Canadian operations are begun, and that understanding must be documented in writing.

An effective model to consider for this relationship is the business franchise model. The relationship between a business franchisor and a franchisee has a close parallel to the relationship between an international parent charity and a member domestic charity. Just as an international charity cannot control the operations of a domestic charity by owning the shares of a domestic charity (because there are no shares to own), a franchisor in a business franchise will not normally own the shares of a franchisee corporation (even though the franchisee corporation has shares that could be owned). Since the franchisee is not a subsidiary, the franchisor can exercise control only through a contractual relationship—i.e., a franchise or some other type of agreement. A similar sort of arrangement could be created by having the Canadian charity enter into a “franchise” relationship with the parent international charity.

A franchise control arrangement between the U.S. organization as
a type of franchisor and the Canadian charity as a type of franchisee, would include the following elements:

**Association agreement.** An association agreement, often referred to as a charter or affiliation agreement, would set out the basic expectations of the U.S. organization with the Canadian charity. It would reflect the similarity of charitable purposes of both organizations, a license of the trademarks and copyrights to the Canadian charity, the contractual requirements of the Canadian charity in carrying out operations in Canada, the corresponding requirements of the U.S. organization, and the consequences for failing to comply with those requirements (including the loss by the Canadian charity of its right to use the licensed trademarks and copyrights). It would also establish a dispute resolution mechanism to avoid litigation in the event of a disagreement.

**Incorporating documents.** An association agreement would include a description of the basic terms required for the incorporating documents of the Canadian registered charity. While recognizing that the Canadian charity is an autonomous legal entity that must comply with applicable Canadian laws, there is nothing to preclude the Canadian charity from entering into a contractual arrangement under which it would agree that its incorporating documents—i.e., its letters patent and by-laws—would need to reflect certain basic requirements, provided that those requirements were not contrary to applicable Canadian law and did not overly diminish the autonomy of the Canadian charity.

Among the terms to be included would be a description of the charitable purposes, the general nature of the organizational corporate structure for the Canadian charity, the reservation of a right to exercise a veto by the U.S. organization over certain fundamental changes in the corporate documents of the Canadian charity, and the U.S. organization’s right to nominate a certain number of U.S. board members as members of the board of the Canadian charity. This board participation could not, however, result in the U.S. organization exercising majority control over the Canadian board of directors, either directly (by allotting more than half of the seats on the board) or indirectly (by increasing the percentage vote required for board resolutions, or the quorum to hold a board meeting, beyond 50% of all board members).

**Trademark and license considerations.** While it is beyond the scope
of this article to outline the steps required to protect trade-marks effectively for charities in Canada, or to draft an effective international trademark license agreement, there are a number of key considerations that U.S. organizations should be aware of in establishing charitable operations in Canada or in other foreign countries. Those considerations include the following:

- The U.S. organization should decide whether its names and logos constitute trademarks that are worth protecting. If they are, those trademarks should be protected by applying for trademark registration in the U.S., in Canada, and in every country that the U.S. organization either operates in or intends to operate in for the foreseeable future.

- The trademark application in Canada should be applied for in the name of the U.S. organization, if possible, instead of having the Canadian charity become the registered owner of the applicable trademarks in Canada.

- A trademark license agreement should be entered into between the U.S. organization and the Canadian charity to identify which trademarks are owned by the U.S. organization and the manner in which the trademarks can be used in Canada. The agreement should also provide appropriate default provisions, including losing the right to use the trademarks in Canada in the event of a breach of the license agreement by the Canadian charity.

- The U.S. organization should take steps to register as many Internet “universal resource locator” (URL) names as possible that include the name and trademarks of the organization, including as many top-level domain names as are still available—i.e., “.org,” “.com,” “.net,” and, in Canada, “.ca.” Separate trademark registration should then be secured for every URL used on the Internet. Even if not all of the Internet URLs that are reserved become activated, these URLs may reduce the chances that another organization will adopt a URL that might cause confusion because of its similarity to the organization’s URL. The trademark license agreement would include a grant of a license from the U.S. organization to the Canadian charity for the right to use one or more specified URLs.

- Both Canada and the U.S. allow trademark applications to be filed based on the “proposed use” of or the “intent to use” a trademark (as opposed to not filing until the trademark is actually in use). The availability of a “proposed use” trademark application in Canada allows the U.S. organization to protect key trademarks in Canada even before beginning operations in that country. In addition, if a Canadian trademark is applied for within six months of the filing date of a trademark application in the U.S., the earlier U.S. filing date can become the effective filing date in Canada as well.

- If the Canadian charity is already operating in Canada without a license agreement, it should be approached about the possibility of signing a trademark license agreement to acknowledge that the trademarks it uses in Canada have been used in its capacity as a licensee of the U.S. organization. The Canadian charity cannot reasonably be expected to give up its trademark rights, however. It will have to be satisfied that, in return for relinquishing those rights, there will be an effective international umbrella organization that will give it the right of proportionate input into overseeing international charitable operations, including those in Canada.

Copyright considerations. One often-overlooked aspect of establishing an effective “franchise” control model over operations in Canada involves the licensing of applicable copyrights. This omission is in part due to complications in dealing with different copyright laws in each country, as well as the impact of international copyright conventions dealing with copyright issues in multiple jurisdictions.

\[\text{3 For a more detailed discussion of the importance of trademark protection for charities in Canada see Carter, "Avoiding Wasting Assets: Trademark Protection for Charities," Charity and Not-for-profit Law: The Emerging Specialty (Canadian Bar Association of Ontario, Continuing Legal Education Program; 1998), also at www.wardlaw.on.ca.}

\[\text{4 See, for example, the Universal Copyright Convention of 1952, the Revised Convention of Berne (11/13/08) and the Additional Protocol Thereto (3/20/16), as well as the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (10/26/61).}\]
Two key factors that should be considered in relation to copyright matters when creating an international structure involving charitable operations in Canada are the following:

- The U.S. organization should determine which of its works are subject to copyright protection and whether copyright registration is necessary. In Canada, as in the U.S., copyright registration is not necessary but can be a helpful precaution in some circumstances, particularly when it involves music and other recorded works.
- The U.S. organization also needs to ensure that it effectively licensed the copyrights in question to the Canadian charity, either as part of an international association agreement or pursuant to a separate copyright license agreement.

Enforcement provisions. There is little point in establishing a franchise control model for charitable operations in Canada unless the U.S. organization is prepared to enforce the control provisions that are set out in its association agreement (or a trademark or copyright license agreement, if one exists). Failure to take consistent action to enforce the available default provisions could result in the Canadian charity being able to assert the doctrine of estoppel to preclude the U.S. organization from relying on the terms of the agreements. This is a very real concern in relation to intellectual property issues involving trademarks and copyrights. The adage of “use it or lose it” is very appropriate to the perishable nature of enforcement provisions involving the licensing of trademarks and other intellectual property.⁵

CONCLUSION

While there are many similarities between the law in the U.S. in dealing with tax-exempt organizations and the law in Canada dealing with “registered charities,” there are considerable differences that require careful planning and analysis. U.S. exempt organizations wishing to establish operations in Canada should be aware of the applicable issues and potential pitfalls that may be encountered, as well as the benefits from establishing an effective international structure before undertaking charitable operations in Canada. Doing so will make it easier to establish a constructive, long-term relationship between the Canadian charity and the U.S. tax-exempt organization that will help fulfill the ultimate goal of both—to accomplish similar charitable purposes in their respective countries and to act in concert internationally.

⁵ For a more detailed discussion of enforcement provisions involving international charitable structures, see Carter, supra note 2.