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Toronto – November 5, 2007

Charity Law Update: The Past Year in Review

(Current as of October 10, 2007)

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent

LAW SOCIETY OF UPPER CANADA
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A. INTRODUCTION 1
B. RECENT CHANGES, RULINGS AND INTERPRETATIONS UNDER THE *INCOME TAX ACT* 1
1. Bill C-33 - Proposed Amendments to the ITA Affecting Charities 1
a) Withdrawal of Reasonable Inquiry Requirement 2
b) Inter-Charity Gifts 3
c) Non-Application of Deemed Fair Market Value 4
2. Federal Budget March 2007 5
b) Excess Business Holding Rules 6
c) Additional Issues Related to the New Self Dealing Rules 8
d) Non-Qualifying Securities 9
e) Loan-Backs 10
f) Gifts of Medicines 11
3. CRA Begins to Administer New Charity Designation Test 11
C. NEW POLICIES AND PUBLICATIONS FROM CANADA REVENUE AGENCY 12
1. CRA Registered Charities Newsletter No. 27 – Fall 2006 12
2. CRA Registered Charities Newsletter No. 28 – Summer 2007 13
a) New Electronic Mailing List 13
b) Registration Statistics 14
c) New Re-Registration Process 14
d) The Objection and Appeals Process for Charities 15
e) Capital Gains Exemption on Gifts of Securities 16
f) New Fillable T3010A, Registered Charity Information Return 16
3. New CRA Policy Statement on Associated Charities 16
4. CRA Guidelines for Applying the New Intermediate Sanctions 17
a) The New Sanctions 17
b) Types of Non-Compliance Subject To Sanction 18
c) CRA'S General Approach 22
d) Procedures 24
5. CRA Issues Warning to Charities on Tax Shelter Gifting Arrangements 25
6. Recent CRA Technical Interpretation - Funding Gifts of Life Insurance 26
7. Recent CRA Ruling - Gift of Art subject to a Loanback 26
8. Employee Donations 27
9. Micro-lending - Individual Development Accounts 27
10. Meaning of Related Business 28
11. CRA Issues Advisory on Partisan Political Activities 28

D. OTHER FEDERAL AND PROVINCIAL LEGISLATION AFFECTING CHARITIES 29
1. New Anti-Terrorism Legislation Passed/Granted Royal Assent 29
a) Increase in Sources and Type of Information Collected 29
b) Expanding the Recipients of Information and the Impact for Charities 30
c) Changes to the ITA 31
2. New Draft Regulations Bring Lawyers Under the Purview of Terrorist Financing Laws . 32
a) The *Proceeds of Crime Act* and the Legal Profession 33
b) ‘Closing the Gap’: The Draft Regulations 34
c) New Compliance Regime and Due Diligence Burden 35
3. Report released from the Special Senate Committee on the *Anti-Terrorism Act* 36
4. Major Changes to Anti-Terrorism Laws Recommended By House of Commons Subcommittee Report 37
a) Recommended Changes to the *Charities Registration (Security Information) Act* 37
b) Other Recommended Changes Impacting Charities 37
5. Proposed New Auditing Requirements Under the *Corporations Act* (Ontario) 38
6. Ministry of Government Services consultation paper on reform to the *Corporations Act* (Ontario) 38
a) The Need for Reform 39
b) The Incorporation Process 39
c) The Structure of the OCA 39
d) Defining the Term “Not-For-Profit Corporation” 40
e) Classification System 41
f) Corporate Powers and Capacity 42
g) Other Relevant Issues and Considerations 43
7. *Trustee Act* (Ontario) to Govern the Investment of Proceeds Under the *Charitable Gifts Act* (Ontario) 44
8. Recent CRTC Changes: Telemarketing and The National Do Not Call List 45
E. RECENT CASE LAW AFFECTING CHARITIES 47
1. Meaning of Charity and Gift 47
a) Supreme Court of Canada Confirms the Common Law With Respect to Charity and Sports Organizations 47
b) Promotion of “Ethical Tourism” Not Considered Charitable 55
2. Regulation of Charities 55
a) CRA Audits of Registered Charities 55
b) Court Says “Place of Worship” Property Tax Exemption Should Be Strictly Construed 56
c) Are Camp Fees subject to G.S.T.? 57
d) Khawaja Decision Affords Little Relief for Charities 58
e) Supreme Court Strikes Down Security Certificates 58
3. Directors’ Liability and Governance 59
a) Non-Share Capital Corporations Must Strictly Adhere to Corporate Governance Procedures 59
b) Non-Share Capital Corporations Must Interpret By-Laws Fairly, Reasonably and in Good Faith 60
c) Corporation’s Right to Regulate Qualifications of Directors 62
d) Decision is Warning to Sham Corporations 63
F. CONCLUDING COMMENTS 64

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A. INTRODUCTION

The charitable sector in Canada has seen a number of important legislative, regulatory and common law developments during the last year which have significantly impacted how charities will operate both in Canada and abroad. The following article provides a brief summary of some of the more important of these developments, including recent changes under the *Income Tax Act* ("ITA")[1], new policies and publications from the Charities Directorate of the Canada Revenue Agency ("CRA")[2], select federal and provincial legislative issues affecting charities, as well as a selection of some of the more significant court decisions during the past year.[3]

B. RECENT CHANGES, RULINGS AND INTERPRETATIONS UNDER THE *INCOME TAX ACT*

1. Bill C-33 - Proposed Amendments to the ITA Affecting Charities[4]

On November 9, 2006, the Department of Finance released the long-awaited Notice of Ways and Means Motion to move forward with a lengthy list of proposed amendments to the ITA. The

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* During the last 12 months, Terrance S. Carter and other lawyers at Carters Professional Corporation (Karen J. Cooper, Theresa L.M. Man, Jacqueline M. Demczur, Esther S.J. Oh, Nancy E. Claridge and Paula J. Thomas) published numerous articles in *Charity Law Bulletin* and in *Charity Law Updates* (available at www.charitylaw.ca), as well as *The Lawyers Weekly*, *Charity Talk* (Canadian Bar Association), *Charitable Thoughts* (Ontario Bar Association), *The Philanthropist*, *Canadian Fundraiser*, *The Bottom Line* and *International Journal of Civil Society Law*. Portions of these previous articles have been incorporated into this article as a compilation, and as such, the author would like to acknowledge these contributions by the other authors at Carters in this regard. The author would also like to acknowledge Kimberley A. LeBlanc, an articling student at Carters, for her assistance in the compilation and editing of this article, as well as Sean S. Carter, a third year law student, for his assistance concerning excerpts from articles related to anti-terrorism law.

[1] R.S.C. 1985, c. 1 (5th Supp.) as amended.

[2] Charities Directorate of Canada Revenue Agency, online: www.cra-arc.gc.ca/tax/charities.

[3] Some important developments which occurred in late 2006 are also included in this article where applicable.

[4] For more information, see Theresa L.M. Man and Terrance S. Carter, "Bill C-33 – Proposed Amendments to the *Income Tax Act* Affecting Charities" in *Charity Law Bulletin* No. 104 (December 7, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.html.

motion was introduced as Bill C-33, and received its first reading in the House of Commons on November 22, 2006 as the *Income Tax Amendments Act, 2006*. Bill C-33 amended and consolidated earlier proposed amendments released on December 20, 2002, December 5, 2003, February 27, 2004 and July 18, 2005. Bill C-33 passed third reading in the House of Commons and first reading in the Senate in June 2007. The government then prorogued Parliament and began a new session on October 16, 2007, leaving Bill C-33 to die on the order paper. The Department of Finance appears to be interested in having the Bill passed, since the proposed changes have been outstanding since 2002. At this point, it is unclear when Bill C-33 will be reintroduced, although it is expected to be in substantially the same form.

A number of the proposed changes contained in Bill C-33 would have substantially impacted the operations of registered charities in Canada. Some of the most significant proposed changes involved the introduction of split-receipting rules and rules to curtail abusive donation tax shelter schemes. These changes are contained in subsections 248(30) to (41) of the ITA. Other proposed amendments included new definitions for charitable organizations and public foundations, rules affecting the revocation of charitable registrations, municipal or public bodies performing a function of government in Canada as new qualified donees, and new expanded disclosure of information concerning registered charities to the public. The provisions contained in Bill C-33 were, for the most part, the same as the amendments released in July 2005, with a few exceptions reviewed below.

a) Withdrawal of Reasonable Inquiry Requirement

One of the main differences between Bill C-33 and the July 2005 proposed amendments was that the previously proposed requirement in subsection 248(40) imposing a heavy onus on a charity to make inquiries of a donor who made a gift with an eligible amount in excess of $5,000 on or after January 1, 2006, was eliminated. The charitable sector and its advisors were very concerned with the proposed statutory onus placed on charities when issuing receipts. In response to a submission made by the Government Relations Committee of the Canadian Association of Gift Planners, Len Farber of the Department of Finance in a letter dated November 22, 2005, advised that the Department of Finance "recognize[d] the difficulties that have been brought to light by this proposal" placing an administrative burden on charities. Mr. Farber indicated that the Department of Finance was "prepared to recommend to the Minister of

Finance that proposed subsection 248(40) be withdrawn." As a result, the proposed reasonable inquiry requirement had been withdrawn from Bill C-33. Notwithstanding the withdrawal of this proposed onerous rule, charities would be still required to exercise due diligence when issuing charitable donation receipts to ensure that the information on the receipts is accurate.

b) Inter-Charity Gifts

In place of the withdrawn reasonable inquiry requirement, the Department of Finance inserted a new provision in subsection 248(40) of the ITA to provide that subsection 248(30), which deals with the intention to give where there is an advantage to the donor, does not apply in respect of a gift received by a qualified donee from a registered charity. This proposed rule will not apply in respect of gifts made before November 9, 2006.

At common law, in order to qualify as a gift, property must be transferred voluntarily with an intention to make a gift. Where the transferor has received any form of consideration or benefit, it is generally *presumed* that such an intention is not present. Subsection 248(30) provides the transferor with an opportunity to rebut this presumption. Specifically, subsection 248(30) provides that the existence of an advantage in respect of a property transferred to a qualified donee (*e.g.*, a registered charity) does not "in and by itself" disqualify the transfer from being a gift under two situations, namely (a) where the amount of the advantage does not exceed 80% of the fair market value of the transferred property, and (b) where the transferor establishes to the satisfaction of the Minister of National Revenue (the "Minister") that the transfer was made with the intention to make a gift. Under the latter scenario, the Explanatory Notes indicated that the taxpayer would need to apply to the Minister for a determination of whether the transfer was made with the intention to make a gift.

By stating that subsection 248(30) does not apply to inter-charity gifts, this means that the common law rule would apply. The Explanatory Notes to Bill C-33 indicated that the application of the presumption rebuttal rule "is unnecessary in the context of inter-charity transfers and could lead to complications of the 'disbursement quota' calculation of a charity." By providing that the presumption rebuttal rule does not apply to inter-charity gifts, the explanatory notes further indicated that "the eligible amount of a gift under new subsection 248(31) should always equal its fair market value."

However, the practical implication and application of this provision is unclear. For example, it is not clear how this rule would apply in situations where the transferor charity of an inter-charity gift receives a benefit from the transferee charity, such as a gift of a property that is subject to a debt. In such a situation, it is not clear what would be the amount to be included in the disbursement quota calculation, *i.e.*, the fair market value of the property gifted, or the net value of the property after deducting the debt.

c) Non-Application of Deemed Fair Market Value

The proposed subsection 248(35) of the ITA introduced a new deeming provision to require the fair market value of the property that is the subject of a gift, for purposes of determining the eligible amount of the gift under subsection 248(31), be *deemed* to be the lesser of (i) the "fair market value of the property otherwise determined," and (ii) the cost (or the adjusted cost base in the case of capital property) of the property to the donor immediately before the gift is made.

The proposed subsection 248(37) set out a list of circumstances in which the deeming provision would not apply, including inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares or ecological gifts. The deeming provision also does not apply to circumstances involving a shareholder transferring property to a controlled corporation in exchange for shares issued by the corporation, and then donating the shares to a charity, or having the corporation donate the shares to a charity. If subsections 85(1) or 85(2) of the ITA applied to the transfer of such an exempt property to the corporation, then subsection 248(37) would preclude the application of subsection 248(35) to that property if it were then donated by the corporation.

In addition to the above, a new exception was introduced in Bill C-33. In this regard, the proposed paragraph 248(37)(g) provided that "a property that was acquired in circumstances where subsection 70(6) or (9) or 73(1), (3) or (4) applied" would be exempt from the application of the deeming provision. The explanatory notes to Bill C-33 indicated that under those situations, the donor will have acquired the property from a transferor (such as a spouse) on a tax-deferred rollover basis. Pursuant to paragraph 248(37)(g), unless the transferor acquired the property within the three-year period referred to in subsection 248(35) (or the 10-year period, where applicable), subsection 248(35) will not apply in these circumstances to deem the value of the gift to the donor's rollover cost or adjusted cost base.

2. Federal Budget March 2007[5]

The Federal Budget released on March 19, 2007[6] ("2007 Budget"), introduced a number of measures which will have a substantial impact on tax planning for charities and their donors. The federal government upheld its commitment from the 2006 Budget to remove the capital gains tax on publicly listed securities donated to private foundations, effective March 19, 2007, but imposed a new excess business holdings regime for private foundations. In addition, the 2007 Budget measures provide an incentive for corporations to donate medicines to charities for international distribution and modify already complicated rules related to gifts of private corporation shares and "loan-backs."

On October 2, 2007, the Department of Finance released draft legislation to implement the second half of the tax measures proposed in the 2007 Budget, including those that deal with charities[7]. From a preliminary review of the draft legislation, it is evident that the basic framework of the legislation, although complicated, is generally consistent with the initiatives that were introduced in the March 2007 Budget provisions. At the time of the preparation of this paper, in early October 2007, the draft legislation has just been released, and therefore, there has been insufficient time to provide an analysis of the draft legislation. What follows, therefore, is a summary of the 2007 Budget initiatives, which generally reflect what is contained in the draft legislation.

a) Extension of Elimination of Capital Gains Tax to Private Foundations

In the 2006 Budget, the federal government had completely eliminated the capital gains tax on gifts of publicly listed securities and ecologically sensitive land to charitable organizations and public foundations, indicating that it would consult with the charitable sector to develop appropriate self-dealing rules to safeguard against potential conflicts of interest before extending

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[5] For more information, see Karen J. Cooper and Terrance S. Carter, "Federal Budget 2007 – Highlights for Charities" in *Charity Law Bulletin* No. 113 (March 29, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[6] For more information, see *Budget 2007: A Stronger, Safer, Better Canada*, available online at: http://www.budget.gc.ca/2007/index_e.html.

[7] For more information, see Legislative Proposals and Explanatory Notes to Implement Remaining Budget 2007 Tax Measures, available online at: http://www.fin.gc.ca/drleg/BIA207_e.html.

the measures to private foundations. After consultations and considerable lobbying by organizations, such as Philanthropic Foundations Canada, the Canadian Association of Gift Planners and Imagine Canada, the 2007 Budget proposes to eliminate the taxation of capital gains arising from donations of publicly-listed securities to private foundations. This measure will also be extended to donations of publicly-listed securities by an arm's length employee who acquired the security under an option granted by the employer and which will exempt the associated employment benefit from taxation.

b) Excess Business Holding Rules

The 2007 Budget introduced an excess business holdings regime for private foundations related to the intermediate sanctions introduced for charities in 2004. The proposed regime places limits on foundation shareholdings that take into account the holdings of persons not dealing at arm's length with the foundation.

The new excess business holdings rules, as set out in the 2007 Budget, will require a private foundation to continuously monitor its holdings and acquisitions of both publicly listed, as well as private corporation shares. Depending upon the amount of its interest in a particular class of shares of a company, a private foundation will be subject to varying requirements, as outlined below:

- "Safe Harbour"

  The new measures provide private foundations with a "safe harbour" of a 2 percent ceiling. Provided that the foundation's holdings in respect of each class of shares it holds in any one corporation does not exceed 2 percent of all outstanding shares of that class, the foundation will not be subject to any requirements under the new excess business holdings rules.

- Monitoring and Reporting

  If the foundation's holdings of one or more classes of shares of a company exceed 2 percent of all outstanding shares of that particular class, the foundation will be required to report to CRA the amount of shares held at the end of the year of all classes in the corporation by the foundation, as well as by non-arm's length persons. For example, if a corporation has three classes of shares and the foundation holds 2 percent of the shares of one of the classes of shares, the foundation will be required to report to CRA the amount of shares it or a non-arm's length person has in each of the three classes of shares of that particular corporation. The foundation will also be required to report in its annual information return any material transactions (e.g. share transactions involving more than $100,000.00 or .5 percent of a class of shares) by the foundation or non-arm's length persons for any period during which the foundation was outside the safe harbour in respect of the corporation.

- Divestment

If the foundation is outside the safe harbour range and the foundation and non-arm's length persons together hold more than 20 percent of the outstanding shares of a particular class of shares of a corporation, a divestment will be required and penalties will be imposed if the divestment does not occur within the time periods specified by the rules. The length of the period within which a foundation will be required to divest itself of excess shares will depend on the manner by which the excess arose:

i) if the foundation purchased shares which would result in an excess at the end of the year, the foundation would be required to divest itself of the excess before the end of that year;

ii) if the excess was acquired as a result of an acquisition of shares by a non-arm's length person or by a donation to the foundation by a non-arm's length person, the foundation would be required to divest itself of the excess before the end of the subsequent taxation year;

iii) if the excess is the result of a donation from an arm's length party or a repurchase of shares by the corporation, the foundation would be required to divest itself of the excess before the end of the second subsequent taxation year; and

iv) if the excess is the result of a donation by way of a bequest, the foundation would be required to divest itself of the excess before the end of the fifth subsequent taxation year.

CRA will have the discretion to specify conditions under which it might defer the year of the divestment obligation upon application by the foundation, by up to five additional years in limited circumstances, such as where divestment of the shares within the normal compliance period would significantly depress the share price or where necessary to accommodate the requirements of securities regulators.

The following is a chart which has been reproduced from Annex 5 of the Budget Plan, Department of Finance, 19 March 2007.

		Private Foundation (Holdings of Share Class)	Non-Arm's Length Persons (Holdings of Share Class)	Action Required by a Foundation
1.	Safe Harbour	2% or less	Any percentage	None
2.	Monitoring Phase	5% 10% 20%	10% 10% 0%	Reporting required
3.	Divestment Required	25% 8% 10% Above 2%	0% 14% 17% Above 18%	Reduce holdings to 20% Reduce holdings to 6%* Reduce holdings to 3%* Reduce holdings to 2%*

*Alternatively, non-arm's length persons could reduce their holdings until the combined holdings of the foundation and non-arm's length persons did not exceed 20%.

c) Additional Issues Related to the New Self Dealing Rules

The Federal Budget addressed a number of additional issues related to the new self dealing rules, including the following:

- Non-arm's Length Persons

  For the purposes of the new excess business holdings regime, the definition of non-arm's length persons as set out in section 251 of the ITA will apply. However, a person may be considered to be dealing at arm's length from the controlling person or member if the person is at least 18 years of age and living separate and apart from the controlling person or member, and the foundation applies to the Minister of National Revenue for a determination of this question of fact.

- Exemption for Shares Made Subject to a Trust

  Foundations will not be required to divest of shares donated before March 19, 2007, if the donation was made subject to a trust or direction that the shares be retained by the foundation and the terms of the gift prevent the foundation from disposing of them. This will also apply to donations made on or after March 19, 2007 and before March 19, 2012, pursuant to the terms of a will signed or an *inter vivos* trust settled before March 19, 2007 and not amended after that date. However, these shares will be taken into account in determining the application of the excess business holdings regime to other shareholdings.

- Proposed Penalty

  A penalty will apply in respect of a foundation's excess business holdings that have not been divested as required. The proposed penalty is 5 percent of the value of excess holdings, increasing to 10 percent if a second infraction occurs within 5 years. Further, if a foundation is subject to such a penalty and has failed to provide information as required in respect of the particular shares, the penalty will be doubled.

- Transitional Provisions and Other

  The proposed excess business holdings rules also include provisions for public disclosure of information reported with respect to certain corporate shareholdings (except the names of non-arm's length persons), specific anti-avoidance measures, grandfathering rules related to existing donations and detailed transitional provisions. Generally, the transitional rules will allow foundations to divest, over a period of 5 to 20 years, excess business holdings existing as of March 18, 2007 at a rate of 20 percent every 5 years until the excess is eliminated. To encourage foundations with excess holdings to divest in a timely fashion, donations made to a foundation which has not completed its transition by the end of its first taxation year beginning after March 18, 2012 will be subject to tax on any capital gains resulting from the disposition.

d) Non-Qualifying Securities

In another measure directed at perceived abuses involving private foundations, the Budget proposes to extend the rules related to donations of non-qualifying securities (ITA ss. 118.1(13) and (14)) to structures involving a trust in respect of which the charity is a beneficiary. A non-qualifying security is a share in a corporation that the donor does not deal with at arm's length and whose shares are not listed on a prescribed stock exchange (private corporation shares) or a debt obligation (e.g., a promissory note) issued by a company or person that is not at arm's length to the donor. In order to ensure appropriate valuations for receipting purposes, donors of non-qualifying securities to private foundations are generally not permitted a charitable donation credit or deduction unless the foundation disposes of the securities within five years of receipt or the security ceases to be a non-qualifying security (e.g. the shares become publicly-listed).

According to the Department of Finance, some donors have avoided these restrictions by transferring their private corporation shares into a trust in respect of which the charity is a beneficiary. A gift is recognized to the extent of the beneficial interest disposed of by the donor, yet the property remains under the control of the donor through the donor's control of the trust. It is proposed that, if the donor is affiliated with the trust, the same restrictions will apply as if the donor had donated the shares in his or her own name and a donation tax credit or deduction will be denied. This measure will apply to gifts made on or after March 19, 2007.

e) Loan-Backs

In a change which will apply to both private and public charities, the Department of Finance is proposing to amend the rules related to "loan-backs" (ITA s. 118.1(16)) Currently, the loan-back provisions in the ITA apply when a donor makes a gift to a qualified donee and within five years of the making of the gift the donee:

i) acquires a non-qualifying security from the donor; or
ii) allows a donor who is not at arm's length to the charity, to use the charity's property within certain time frames.

In such instances, the donor has to reduce the eligible amount of the gift by the value of the property used, even if the donor is paying rent or giving the qualified donee something in exchange for the right to use the property.

According to the Department of Finance, some charities will accommodate arm's length donors who make their donations with the requirement that property be loaned back. The budget proposes to extend the loan back rules to include arm's length donors as well, applicable to gifts made on or after March 19, 2007.

f) Gifts of Medicines

The 2007 Budget also proposes to allow a special deduction for corporations that make donations of medicines from their inventory to registered charities that have received a disbursement under a program of the Canadian International Development Agency in respect of activities of the charity outside of Canada.

Currently, donations by corporations of property held in inventory are eligible for a charitable donation deduction equal to the fair market value of the property gifted. However, the economic impact of this donation is reduced by virtue of the requirement in subparagraph 69(1)(b)(ii) of the ITA to include the fair market value of the item in income. In order to provide an incentive for corporations to participate in international programs for the distribution of medicines, the Department of Finance is proposing to allow corporations that make donations of medicines from their inventory to claim a special additional deduction equal to the lesser of 50 percent of the amount, if any, by which the fair market value of the donated medicine exceeds its cost and the cost of the donated medicine. This measure will apply to gifts made on or after March 19, 2007.

3. CRA Begins to Administer New Charity Designation Test[8]

The CRA has clarified that although Bill C-33 has not been enacted, CRA has begun reviewing applications for charitable status and for re-designation by using the proposed new definition for charitable organization and public foundation (which also affect the definition for private foundation). The new definition replaced the “contribution test” with a “control test.” Under the new “control test,” more than 50% of the capital of a charitable organization or public foundation can be contributed by a person or a group of related persons, provided that they do not control the charity in any way. In addition, this person, or members of the related group, may not represent more than 50% of the directors, trustees, officers and similar officials of the charitable organization or public foundation. Charities that do not meet this test will be designated as private foundations.

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[8] Theresa L.M. Man in *Charity Law Update*, July/August 2007 at p. 2, online: http://www.carters.ca/pub/update/charity/index.html.

Applications for re-designation can be made retroactively for taxation years that begin after 1999. Registered charities will have until 90 days after the successor to Bill C-33 receives Royal Assent to apply for retroactive re-designation. Applications received after that date will fall under these new rules, but the re-designation will only become effective for future taxation years. CRA is currently developing guidelines for applying the new "control test." To view further details on the administration of these changes, please refer to CRA's website at http://www.cra-arc.gc.ca/tax/charities/whatsnew/changes-e.html.

C. NEW POLICIES AND PUBLICATIONS FROM CANADA REVENUE AGENCY

1. CRA Registered Charities Newsletter No. 27 – Fall 2006[9]

In December 2006, CRA released the Fall 2006 edition of its Registered Charities Newsletter.[10] Included in the newsletter is information concerning the application of new intermediate sanctions for non compliance of charities. There is also a series of questions and answers relating to identifying the donor with respect to official donation receipts,[11] enduring property (see paragraph below for more information), and planned giving arrangements, including charitable gift annuities,[12] life insurance policies and charitable remainder trusts.[13] The newsletter also addresses CRA's policy on "public benefit,"[14] debts incurred by charitable foundations,[15] restrictions on private foundations,[16] the definition of "non-qualified investment" under the ITA,[17] and the gift of residue qualifying as a "gift by the individual's will."[18]

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9 For more information, see Theresa L.M. Man and Paula J. Thomas, "CRA Registered Charities Newsletter Highlights from 2006" in *Charity Law Bulletin No. 109* (January 25, 2007) at www.charitylaw.ca.

10 CRA, online: www.cra-arc.gc.ca/tax/charities/newsletters-e.html.

11 See paragraphs 3501(1)(g) and 3501(1.1)(g) of the *Income Tax Regulations*, C.R.C., c. 945. See also CRA, Policy Commentary CPC-010, *Name on Official Donation Receipt*, online: www.cra-arc.gc.ca/tax/charities/policy/cpc/cpc-010-e.html.

12 More information on charitable gift annuities can be found in *Income Tax - Technical News No. 26*, which is available on the CRA website at: www.cra-arc.gc.ca/E/pub/tp/itnews-26/README.html.

13 More information on the valuation of charitable remainder trusts can be found in IT-226R, *Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust*, which is available on the CRA website at: www.cra-arc.gc.ca/E/pub/tp/it226r/README.html.

14 CRA, Reference Number CPS-024, online: www.cra-arc.gc.ca/tax/charities/policy/cps/cps-024-e.html.

15 For more information, see Theresa L.M. Man, "Foundations Incurring Debts to Purchase Investments" in *Charity Law Bulletin* No. 86 (February 7, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.htmland CRA Technical Interpretation 2005-0154751I7, Debts Incurred By Charitable Foundations, October 21, 2005.

16 For example, see CRA's Policy Statement CPS – 019, "What is a related business?", online: www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html.

17 *Supra* note 1 at subsection 149.1(1).

18 *Supra* note 1 at subsection 118.1(5).

CRA's summary of "enduring property" arising from amendments to the ITA in May 2005 is helpful and provides as follows: "The definition of "enduring property" applies for the purpose of the definition "disbursement quota" and applies to fiscal periods that begin after March 22, 2004. Gifts of enduring property are generally excluded from the charity's disbursement quota in the year they are received. However, the charity must consider these gifts when calculating the average value of property for its 3.5% disbursement quota requirement. When the charity spends or transfers some or all of the enduring property, 80% of the amount spent or 100% of the amount transferred must be included when calculating the disbursement quota requirement. Transfers from registered charities to charitable organizations were previously exempt from the recipient charitable organization's disbursement quota. Under the new disbursement quota rules, there are three types of property transfers between charities: specified gifts, enduring property and other gifts, which are each treated differently."

2. CRA Registered Charities Newsletter No. 28 – Summer 2007[19]

The CRA released the Summer 2007: Registered Charities Newsletter No. 28 in August 2007[20] This Newsletter focuses on information with respect to public education and compliance issues within the regulatory environment for charities. It also addresses legislative changes that have been implemented with respect to re-registration, the objection and appeals process for charities and capital gains exemptions on gifts of securities. The Newsletter also discusses recent technological advancements at the Charities Directorate. Specifically, the creation of a new electronic mailing list promises to assist charities in keeping informed about important CRA information. In addition, a fillable T3010A, Registered Charity Information Return has been developed to facilitate the filing process for charities.

a) New Electronic Mailing List

The CRA encourages charities and their officers, directors, and employees to subscribe to the Charities Directorate's "What's New Electronic Mailing List" ("EML"). This is a free service offered by the CRA to "…support sustainable development, to provide timely and up-to-date

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[19] For more information, see Terrance S. Carter and Kimberley A. LeBlanc, "Highlights of CRA Registered Charities Newsletter No. 28 Summer 2007" in *Charity Law Bulletin No. 124* (September 26, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[20] CRA, *Registered Charities Newsletter* No. 28, online: http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-28/charitiesnews-28-e.html.

information, to remain fiscally responsible, and to ensure continued compliance by both the charities sector and the public."[21]

Those who sign up for the EML will be "…notified by email about new policy statements and commentaries, draft guidelines for consultation, new calls for proposal for the Charities Partnership and Outreach Program, various outreach activities, the Charities Newsletter, and substantial changes or new information added to the Charities Directorate Web site."[22]

b) Registration Statistics

The CRA reported preliminary statistics on registration and denials of charities as a result of a recommendation by the Joint Regulatory Table[23] to establish a policy of denying applications where applicants "…do not respond within ninety days to communications from the regulator."[24]

The CRA implemented this policy effective June 13, 2005. The statistics illustrate a marked increase in turn down letters following the execution of this policy compared to the previous year. In the 2005/2006 fiscal year, fifty-two applications for charitable status were turned down. In comparison, three hundred and twenty-six applications were denied in 2006/2007, more than a 6 fold increase. As a result, it will be very important for organizations applying for charitable registration to ensure that they have responded to communication from CRA within 90 days.

c) New Re-Registration Process

Charities that fail to file their annual information return, Form T3010A, within the prescribed six months following their fiscal year end, are subject to the revocation of their charitable status, but are able to apply for re-registration in accordance with a new re-registration requirement of a $500 penalty imposed by CRA. This new re-registration requirement comes as a result of a recommendation by the Joint Regulatory Table[25] providing for a $500.00 late filing penalty to charities. At the present time, CRA has decided to only implement the aforementioned penalty when the charity is applying for re-registration as opposed to at the time of revocation.

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21 *Ibid.* at 3.
22 *Ibid* at 3.
23 This group was comprised of representatives of the government and voluntary sector. Their work culminated in *Regulatory Reform Final Report: Strengthening Canada's Charitable Sector,* which can be found on the Voluntary Sector Initiative's website at: http://www.vsi-isbc.ca/eng/regulations/jrt_finalreport/index.cfm.
24 *Supra* note 23 at 4.
25 *Supra* note 26.

As has been the case for any charity that has lost its charitable status for failure to file in the past, it may apply for re-registration by providing all missing annual information returns, as well as Form T2050, Application for Registration.

d) The Objection and Appeals Process for Charities

The CRA provides an overview of the new appeals process for charities contesting a CRA decision. This will have a significant impact on charities, as the objections process is now mandatory prior to making an appeal to court. Charities challenging a CRA decision are no longer limited to an appeal at the Federal Court of Appeal ("FCA"). Charities now have access to the existing appeals process used by other taxpayers.

The Newsletter states that the Charities Redress Section in the Appeals Branch of the CRA will now process all objections by charities pertaining to the following notices issued by the CRA after June 12, 2005:

- Notice of refusal of registration;
- Notice of intention to revoke a registration;
- Notice of annulment of a registration;
- Notice of designation of registered charities as public or private foundations, or charitable organizations;
- Notice of assessment concerning a revocation tax or one of the financial penalties applicable to charities;
- Notice of suspension of tax-receipting privileges and qualified donee status.[26]

The Newsletter advises, that where a charity contests that the CRA has failed to interpret the facts or to apply the law correctly, it can object by submitting a written objection, which sets out all reasons and relevant facts, to the Appeals Branch, no later than ninety days after the mailing date of the notice. The CRA also details that where a charity does not file its objection on time, due to circumstances beyond its control, the charity can apply for an extension for up to one year following the original ninety day limit.

The Newsletter states that for the first four CRA notices listed above, if a charity disagrees with the decision on its objection, it can appeal to the FCA, but must do so within thirty days of the Appeal Board's decision. For the last two notices listed above, a charity must appeal an objection

[26] *Supra* note 23 at 5.

decision to the Tax Court of Canada within ninety days of the Appeal Board's decision. However, no appeal can be made either to the Tax Court of Canada or the FCA without going through the new objection process.

e) Capital Gains Exemption on Gifts of Securities

The Newsletter also discusses the federal government's budget initiatives in 2006 and 2007 which have resulted in the complete elimination of the capital gains tax on gifts of publicly listed securities and ecologically sensitive land to charitable organizations and public foundations, as well as the elimination of the taxation of capital gains arising from donations of publicly-listed securities to private foundations .

f) New Fillable T3010A, Registered Charity Information Return

The Newsletter announces the Charities Directorate's initial step towards providing charities with the opportunity to file their annual information return electronically through its explanation of the newly developed fillable T3010A, which is currently available on the Charities Directorate's website at http://www.cra-arc.gc.ca/E/pbg/tf/t3010a/t3010a-fill-05e.pdf. Although the fillable form cannot be filed electronically as of yet, charities are able to enter their information into the return on their computer prior to printing it and submitting it to the Charities Directorate by mail.

When completing the form online, charities will be able to access help functions, links to Guide T4033A - Completing the Registered Charity Information Return and prompted instructions assisting the user with specific actions. Charities should be aware that they will be unable to electronically save information entered into the fillable form for future use without an advanced version of the Adobe Acrobat software.

3. New CRA Policy Statement on Associated Charities[27]

CRA released a Policy Statement (CPC-028) on February 26, 2007 to clarify that two unrelated charities that carry on a joint project can apply to CRA to be designated as associated charities pursuant to subsection 149.1(7) of the ITA. The effect of the designation would allow one charity to transfer over 50% of its annual income to the other charity so designated. An

[27] Theresa L.M. Man in *Charity Law Update*, March 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html.

application would need to be submitted to CRA disclosing details regarding the joint project. The designation would be in effect for the duration of the joint project. If the joint project is not completed within the time frame specified, the charities can request to have the designation extended. On the other hand, if the joint project is completed earlier than the expected time frame, the charities should request the revocation of the designation. This policy statement is consistent with CRA's circular IC77-6 "Registered Charities: Designation as Associated Charities," April 18, 1977.

4. CRA Guidelines for Applying the New Intermediate Sanctions[28]

On April 10, 2007, the CRA released a new policy document, "Guidelines for Applying the New Sanctions" (the "Guidelines").[29] This document sets out CRA's approach to the application of the new intermediate sanctions resulting from amendments to the ITA enacted by Bill C-33, *A second Act to implement certain provisions of the budget tabled in Parliament on March 23, 2004*, which received Royal Assent on May 13, 2005.[30]

a) The New Sanctions

The ITA now includes two new kinds of penalties: (1) financial penalties; and (2) a one-year suspension of the charity's ability to issue official donation receipts. Usually a financial penalty is invoked first. Repeated violations may lead to higher financial penalties and sometimes the suspension of the right to issue official donation receipts. Initially, this right is normally suspended for the duration of one year only. A charity which has a financial penalty greater than $1000 may choose to pay the amount to a charity which is an eligible donee, rather than paying it to the Receiver General. Eligible donees are essentially arm's length charities which are not under any interim sanction by CRA.[31]

If a sanction is imposed on a charity, a variety of information about the charity will be made public on the Charities Directorate's website, including:

[28] For more information, see Karen J. Cooper and Paula J. Thomas, "Guidelines for Applying the New Intermediate Sanctions for Charities", in *Charity Law Bulletin No. 117* (June 14, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[29] Available online at: http://www.cra-arc.gc.ca/tax/charities/policy/newsanctions-e.html.

[30] See Karen J. Cooper, "Changes to Sanctions, Penalties and Appeals Process for Charities" in *Charity Law Bulletin* No. 82 (January 11, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[31] *Supra* note 1 at subsection 188(1.3).

- The charity's name;
- The sanction applied, including the dollar amount (if applicable);
- The date on which the sanction became effective;
- The reason for the penalty; and
- The results of the appeal (if applicable).

In order to avoid the imposition of more rigorous sanctions, there are a number of obligations that a charity must fulfill while its charitable status is under suspension, including informing any individuals and organizations planning to make a donation to the charity of its suspended status. The charity is permitted to receive donations but it cannot issue official donation receipts. If it does so, CRA intends to revoke the organization's charitable status. Where one charity is making a gift to another suspended charity and the donating charity is aware of the charity's suspended status and accepts an official donation receipt, CRA intends to suspend the donating charity's charitable status.[32]

b) Types of Non-Compliance Subject To Sanction

- Business Activities

  A charitable organization or a public foundation which carries on an unrelated business, or a private foundation which carries on any kind of business, is subject to penalties. CRA has a Policy Statement on what constitutes a related business. It outlines the Charities Directorate's policy "for determining whether an applicant organization or an existing registered charity is carrying on an acceptable business (a "related" one) or an unacceptable business (an "unrelated" one)."[33]

  Normally, CRA will provide a charity with the opportunity to cease from operating the business or unrelated business. Usually this opportunity is provided by way of a compliance agreement. If the charity initially fails to divest itself of the business or unrelated business, the penalty is 5% of the gross revenue from the business. For a subsequent infraction, the penalty is 100% of the gross revenue, as well as a one-year suspension.

[32] Subsection 188.2(3) of the ITA deems the suspended charity not to be a qualified donee.
[33] Canada Revenue Agency, Policy Statement CPS-019, "What is a Related Business?", Effective Date: March 31, 2003, online: http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html.

- Control of a Corporation (foundations only)

  A penalty applies if a public foundation or a private foundation acquires control over a corporation, unless the foundation received the controlling shares as a donation. CRA's Summary Policy on this subject contains further information.[34] Unless the infraction is considered serious, CRA will normally address this issue by way of a compliance agreement. The penalty for a first-time infraction is 5% of the dividends which the corporation pays to the charity in a year. For a subsequent infraction, the penalty is 100% of the dividends.

- Gifts to Non-Qualified Donees

  A penalty applies in the situation where a charity makes a gift to a person (*i.e.*, under the ITA a "person" is an individual, company or a partnership) who is not a qualified donee. Qualified donees are those entities which are permitted to issue official donation receipts in exchange for gifts, which includes, among others, registered charities, registered Canadian amateur athletic associations, municipalities, and the United Nations and its agencies. Again, unless the infraction is considered serious, CRA's preference is to address the problem by way of a compliance agreement. The penalty for a first infraction is 105% of the amount donated to a non-qualified donee. For a repeat infraction, the penalty is 110% of the amount.

- Undue Benefit

  A penalty applies to a charity (or to a third party acting with the charity's knowledge or on its instructions) which confers an "undue benefit" on:

  - A member of the charity or a member of its board of directors;
  - A person who has given more than 50% of the charity's capital;
  - A person who is not at arm's length to another person:
    - who is a member of the charity or its board of directors; or
    - who has given more than 50% of the charity's capital; or
  - A person who is not at arm's length to the charity.

  In order to avoid being considered as having conferred an undue benefit, a charity can make a reasonable payment for the services or property received from any of these persons.

[34] Canada Revenue Agency, Summary Policy CSP - C28, "Control of Corporations - Sanctions", November 3, 2005, online: http://www.cra-arc.gc.ca/tax/charities/policy/csp/csp-c28-e.html.

As in the previous examples, unless the violation is serious, CRA will normally enter into a compliance agreement with the charity. The penalty for a first infraction is 105% of the benefit. For a repeat infraction, the penalty is 110% of the amount, as well as a one-year suspension.

- False Information on Official Donation Receipts

  A penalty applies if an officer, employee, official or agent of the charity issues an official donation receipt containing false information. The penalty could also apply to other people who:

  - Counterfeit the official donation receipts of a legitimate charity; or
  - Issue false receipts on behalf of an organization which is ineligible to issue them.

  As CRA considers false information a serious infraction, more severe sanctions are imposed, including proceeding directly to revocation. The Guidelines indicate that "for any infraction, the penalty is 125% of the eligible amount of the gift as it appears on any false receipt, plus a year's suspension if the total of all such penalties exceeds $25,000. If by issuing false receipts, the person is also subject to a penalty under section 163.2 of the ITA (the section that provides for penalties for those who help or encourage others to make false claims on their tax returns, usually as part of a tax-shelter promotion),[35] the person is subject to whichever penalty is larger."

- Incorrect Information on Official Donation Receipts

  A penalty applies to a charity which issues an official donation receipt which contains incorrect information as distinguished from false information. Incorrect information includes omitted information that should be contained on the receipt, such as CRA's website address: www.cra.gc.ca/charities. Samples of official donation receipts are included on CRA's website.[36]

[35] For further information on section 163.2 of the ITA, see CRA's Information Circular 01-1 "Third-Party Civil Penalties", online: http://www.cra-arc.gc.ca/E/pub/tp/ic01-1/README.html.

[36] Canada Revenue Agency, "Samples - Official Donation Receipts", online: http://www.cra-arc.gc.ca/tax/charities/pubs/receipts-e.html.

As in most of the examples, unless the infraction is serious, CRA will enter into a compliance agreement with the charity. The penalty for a first infraction is 5% of the eligible amount of the gift as it appears on the incorrect receipt. For a repeat infraction, the penalty is 10% of the amount.

- Inadequate Books and Records

  A penalty applies to a charity which does not maintain adequate books and records, as well as to a charity which does not permit an auditor the right to review the books and records, or permission to copy them. Further information about books and records can be found on CRA's website.[37]

  Compliance agreements are generally invoked first. However, sanctions will be imposed on more serious infractions, possibly even revocation of charitable registration. The penalty for an infraction involving inadequate books and records is a one-year suspension.

- Inter-charity Gifting to Delay Expenditures

  A charity is subject to a penalty if it exchanges gifts in order to delay expenditures required to meet its disbursement quota. CRA provides the following example: "Two charities have a disbursement quota of $10,000. Charity A writes a $10,000 cheque to Charity B, and Charity B writes an equivalent cheque to Charity A. Both claim to have met their disbursement quota on the basis of a $10,000 gift to a qualified donee, but in reality neither charity has made any expenditure."

  CRA considers this a serious infraction, and as such it would proceed directly to applying a penalty. Both charities are subject to a penalty equivalent to 100% of the amount that was exchanged. Sometimes the penalty is split between the two charities, but in some cases CRA will apply the entire penalty against either charity.

[37] Canada Revenue Agency, "Registered Charities and the *Income Tax Act*", online: http://www.cra-arc.gc.ca/E/pub/tg/rc4108/ and *Charities Registered Newsletter* No. 26, online: http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-26/README.html.

- Not Filing the Annual Return

  A penalty applies to a charity which does not file its annual return on time. The ITA provides for a $500 penalty for this infraction. CRA currently only applies this penalty to charities which:

  - have had their registration revoked for not filing an annual return; and
  - apply for re-registration of charitable status.

  Charities which lose their charitable registration must proceed quickly to avoid the revocation tax imposed under the ITA.[38] Within twelve months of the receipt of a notice from CRA that it intends to revoke a charity's registered status, the charity must:

  - rectify its filing deficiency;
  - pay any outstanding penalties, including the $500 non-filing penalty indicated above, as well as taxes and interest pursuant to the ITA and the *Excise Tax Act*;[39] and
  - obtain re-registration.

- Failure to Divest of Excess Business Holdings (private foundations only)

  As noted above, in the 2007 Budget, the federal government imposed a new excess business holdings regime for private foundations. The draft 2007 Budget legislation, released by the Department of Finance on October 2, 2007, sets out the provisions to implement this regime.

  In this regard, a penalty will apply in respect of a foundation's excess business holdings that have not been divested as required. The proposed penalty is 5 percent of the value of excess holdings, increasing to 10 percent if a second infraction occurs within 5 years. Further, if a foundation is subject to such a penalty and has failed to provide information as required in respect of the particular shares, the penalty will be doubled.

c) CRA'S General Approach

Until recently, the end product of an audit was either revocation of the charity's registered status or the issuance of an undertaking letter requiring the charity to carry out certain corrective

[38] For further information about re-registration and the revocation tax, see "Completing the Tax Return Where Registration of a Charity is Revoked", online: http://www.cra-arc.gc.ca/E/pub/tg/rc4424/README.html.
[39] R.S.C. 1985, c. E-15.

actions to become compliant. Under the new regime, CRA will have four tools to ensure that registered charities comply with their obligations:

- Education (either general publications or a letter specifically addressed to a charity explaining its obligations under the ITA);
- Compliance agreement (similar to the former undertaking letter);
- Imposition of an interim sanction or penalty (a financial penalty or the suspension of the charity's status as a qualified donee and the capacity to issue official donation receipts; and
- Revocation of registered charitable status.

Most cases of non-compliance related to issues which can be sanctioned under the new legislation will be addressed through the use of a compliance agreement. This agreement will outline the non-compliance issues and remedial actions which the charity has agreed to undertake in order to comply with its obligations under the ITA. It will also include a paragraph which advises the charity that a penalty and/or suspension could apply if the agreement is not upheld. As opposed to the current undertaking letter, the Compliance Agreement will be a formal document signed and dated by both parties and will include a timeframe for the charity to make the necessary changes as outlined in the agreement. The cover letter that will accompany the agreement may also address other minor non-compliance issues that may have been identified but that do not form part of the agreement. As a general rule, the Charities Directorate intends to start with educational methods to obtain compliance, and then move progressively through compliance agreements, sanctions, and the ultimate sanction of revocation, if necessary.

However, in cases of serious non-compliance, CRA intends to move directly to the imposition of a sanction or revocation. The Guidelines identify examples of serious non-compliance from CRA's perspective, including:

- Where non-compliance reaches a particular upper limit, *e.g.*, the percentage of funds spent on non-charitable activities is too high;
- Where non-compliance involves breaches of the *Criminal Code*[40] or other quasi-criminal statutes;
- Where non-compliance involves violations of central provisions of the ITA; or
- Where charity is not acting in accordance with the terms of a compliance agreement.

[40] R.S.C. 1985, c. C-46.

The Guidelines also indicate a number of examples of "aggravated non-compliance" which would likely lead directly to revocation:

- The charity has a history of serious non-compliance and its current lack of compliance is considered both serious and deliberate;
- The non-compliance is having a negative impact on others, such as beneficiaries and donors, and the charity is either unable or unwilling to reverse that adverse impact; or
- The charity is either unable or unwilling to bring itself into compliance.

The Guidelines provide two further examples of action or inaction on the part of charities that will probably result in the revocation of charitable status:

- Where, after a maximum of one reminder, a charity fails to file its annual return; and
- Where there is no appropriate sanction for a serious breach, *e.g.*, engaging in non-charitable activities.

The Charities Directorate acknowledges that exceptional situations beyond a charity's control do occur, in which case, a less severe sanction would likely be imposed.

d) Procedures

CRA's auditors, sometimes in conjunction with the Charities Directorate staff, determine whether to encourage a charity's compliance by way of education or through a compliance agreement. If a subsequent examination of an organization that was dealt with by education letter or compliance agreement reveals that the charity has not fulfilled its obligations under the agreement or the audit findings are sufficiently serious, CRA may apply the relevant penalty or sanction. An auditor's supervisor also plays a key role in evaluating which intermediate sanction to use.

Once the charity has been informed of the sanction, it has a 30-day window in which to propose why it should not be subject to the proposed sanction. The Charities Directorate will then make a decision with respect to whether to impose a sanction and then it notifies the charity accordingly. If a sanction is imposed, the charity then has a 90-day window in which to object to the sanction by filing a notice of objection with the CRA's Appeals Branch. Should a suspension be invoked, the charity may make an application to the Tax Court of Canada to postpone the application of the suspension. As indicated above, there may be situations of what CRA terms "aggravated non-compliance" on the part of charities, in which case there would likely be a direct move toward revocation. In such a situation, a charity would have 30 days in which to file a stay with the FCA.

5. CRA Issues Warning to Charities on Tax Shelter Gifting Arrangements[41]

The CRA issued a warning to registered charities on June 4, 2007 with respect to their becoming involved in tax shelter gifting arrangements. CRA has warned that participating in such arrangements can jeopardize their charitable status or expose them to monetary penalties. Examples of tax shelter gifting arrangements identified by CRA include gifting trust arrangements, leveraged cash donations, and buy-low, donate-high schemes. The CRA warns that it intends to challenge and proceed with compliance action against any arrangement that does not comply with the ITA and that charities which knowingly exploit their tax receipting privileges by participating in schemes that are abusive or fraudulent, or that fail to devote their resources to legitimate charitable activities, will be subject to revocation and/or significant penalties. In addition, the CRA may also apply penalties against those persons who promote such arrangements or who participate in making false statements to the CRA. The warning is available on our website at http://www.carters.ca/news/2007/CRA0604.pdf.

In conjunction with a News Release issued by the Minister of National Revenue (see http://www.craarc.gc.ca/newsroom/releases/2007/august/nr070813-e.html), the CRA issued a Tax Alert on August 13, 2007 warning taxpayers about the consequences of participating in a tax shelter gifting arrangement (see http://www.cra-arc.gc.ca/newsroom/alerts/2007/a070813-e.html). In the Tax Alert, CRA urges taxpayers to avoid tax shelter gifting arrangements and warns that it intends to audit all such arrangements. To date, the CRA has reassessed over 26,000 taxpayers who participated in these schemes, and denied about $1.4 billion in donations claimed. Audits of another 20,000 taxpayers involving $550 million in donation claims are just about complete and audits on other arrangements involving over 50,000 taxpayers are about to begin.

Originally, tax shelter gifting arrangements involved donations of gifts-in-kind (artwork) and leveraged charitable donations. Later, donation of other property was involved, such as comic books, figurines, plates, stamps, jewellery, medical supplies, computer programs, educational

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[41] Terrance S. Carter in *Charity Law Update,* May/June 2007 at p. 3, online: http://www.carters.ca/pub/update/charity/index.html and Karen J. Cooper in *Charity Law Update*, September 2007 at p.3, online: http://www.carters.ca/pub/update/charity/index.html.

products, food, clothing and pharmaceutical products. Common forms of these donation tax shelters also involve "buy-low donate-high" tax shelters (where the donation tax receipt is sometimes 3 to 4 times the initial outlay of cash), gifting trust arrangements and leveraged charitable donation arrangements.[42] Both charities and donors alike are advised to exercise caution when considering any involvement in such schemes and should consider obtaining independent professional advice before participating in a tax shelter gifting arrangement.

6. Recent CRA Technical Interpretation - Funding Gifts of Life Insurance[43]

In a technical interpretation released on June 5, 2007[44], CRA discusses the disbursement quota implications of making a gift of a life insurance policy and the premiums related thereto subject to a direction that both be held for a period of at least ten years. The gift would be considered a gift of "enduring property" and would not be included in the charity's disbursement quota in the year following receipt but would be included in the year in which the charity expends or transfers the property. In addition, while enduring property must be considered when determining the value of property for the charity's 3.5% disbursement quota requirement, a life insurance policy (but not the proceeds) is deemed to have a value of nil for this purpose. CRA also considers the application of paragraph 8 of IT-244R3, *Gifts of Individuals of Life Insurance Policies as Charitable Donations*, to a situation where a charity uses one or more ten-year gifts to pay the annual premiums on a life insurance policy it has acquired directly from an insurer and indicates that the charity must hold the life insurance policy and any proceeds on the policy until such time that the ten-year period has elapsed from the date of the last premium payment.

7. Recent CRA Ruling - Gift of Art subject to a Loanback[45]

As re August 2007[46], CRA issued an advance income tax ruling involving a situation where the donors have gifted various works of art to a designated cultural institution. The gift is subject to a loan agreement which provides that when the works are not being used by the institution for

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[42] For more information, see Theresa L.M. Man, Karen J. Cooper and Terrance S. Carter, "Donation Tax Shelters Involving Flow-Through Shares" in *Charity Law Bulletin* No. 116 (June 12, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html for a general discussion of such arrangements and a detailed discussion of arrangements involving "flow-through shares."

[43] Karen J. Cooper in *Charity Law Update*, July/August 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html.

[44] "The Tax Window" *Window on Canadian Tax Newsletter*, Report No. 193 (August 2007) at p. 16.

[45] Karen J. Cooper in *Charity Law Update*, July/August 2007 at p. 3, online: http://www.carters.ca/pub/update/charity/index.html.

[46] "The Tax Window" *Window on Canadian Tax Newsletter*, Report No. 193 (August 2007) at p. 19.

exhibition, research or other related purposes, the works are to be loaned to the donors. The conditions of the loanback require that the donors not earn any revenue form the art and that the art be properly maintained. If the art is required by the institution for any purpose or the donors do not respect their obligations under the loan agreement, the art must be returned to the institution. CRA concluded that the loanback arrangement was an advantage within the meaning of proposed subsection 248(32) of the ITA, that the existence of the advantage will not, in and of itself, nullify the gift, and that the proposed deemed fair market value provision will not apply if the art is certified cultural property.

8. Employee Donations[47]

CRA has recently ruled that a charity can issue tax receipts for donations received from its employees to a donor-supported fund the purpose of which is to further the professional development of the employees of the organization (CRA Income Tax Rulings, document no. 2005-015977). The objects of the charity were to provide educational programs and services which enable adults to continue their education, to improve their employment opportunities, and to enhance their quality of life. The proposed employee donation policy provides that eligibility for participation in professional development activities of the organization is not contingent on making donations to the Development Funds, nor do employee donations have any bearing on the charity's decision concerning who can participate in professional development activities. Having regard to the proposed guidelines for the disbursement of funds from the donor-supported fund and provided that no correlation exists between an employee's donation to the Development Funds and the employee's receipt of an award, the employee donations qualify as gifts for the purposes of the ITA.

9. Micro-lending - Individual Development Accounts[48]

In a technical interpretation (document number 2006-018028, dated February 2, 2007), CRA discussed the income tax treatment of amounts paid from an Individual Development Account to Canadian taxpayers. Generally, amounts paid in respect of housing and health care would be social assistance payments that, because they are paid as lump sums, would be excluded from

[47] Karen J. Cooper in *Charity Law Update*, February 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html.
[48] Karen J. Cooper in *Charity Law Update*, February 2007 at p. 5, online: http://www.carters.ca/pub/update/charity/index.html.

income by virtue of subsection 233(2) of the Regulations. Amounts paid for education would generally be considered scholarships or bursaries and included in income under paragraph 56(1)(n). Grants paid to individuals to assist them in starting their own businesses would likely be included in income under paragraph 12(1)(x) of the Act. However, the particular facts of each payment under such programs should be carefully reviewed and that the income tax consequences may change depending upon the particular circumstances of the organization and the recipient.

10. Meaning of Related Business[49]

CRA recently issued a ruling with respect to the meaning of related business for the purposes of paragraph 149.1(3)(a) of the ITA. In the ruling, CRA considered a situation involving a public foundation which owned 50% of the common voting shares of a private corporation. The public Foundation also owned all of the shares of one class of dividend paying preferred shares. CRA ruled that the receipt of dividends on the preferred shares did not in and of itself amount to a business activity which was not a related business activity within the meaning of the Act. In addition, CRA ruled that the ownership of 50% of the common shares in the context of the proposed activities of the corporation did not amount to an acquisition of control of the private corporation within the meaning of paragraph 149.1(3)(c). CRA Document # 2007-021848.

11. CRA Issues Advisory on Partisan Political Activities[50]

On September 24, 2007, the CRA once again issued an advisory to remind registered charities that there are limitations on certain types of political activities (available at http://www.cra-arc.gc.ca/tax/charities/policy/advisory-e.html). The Advisory indicates that during election campaigns, the CRA steps up monitoring of activities of registered charities and that it will take appropriate measures if a registered charity undertakes partisan political activities. Partisan political activities are those that involve direct or indirect support of, or opposition to, any political party or candidate for public office. Registered charities are prohibited from partisan political activity, because supporting or opposing a political party or candidate for public office is not a charitable purpose at law. Charities should be aware of the Advisory and CRA's more

[49] Karen J. Cooper in *Charity Law Update*, September 2007 at p. 5, online: http://www.carters.ca/pub/update/charity/index.html.
[50] Karen J. Cooper in *Charity Law Update*, September 2007 at p. 2, online: http://www.carters.ca/pub/update/charity/index.html.

detailed policy statement, *CPS - 022: Political Activities*, available at http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-022-e.html.[51]

D. OTHER FEDERAL AND PROVINCIAL LEGISLATION AFFECTING CHARITIES

1. New Anti-Terrorism Legislation Passed/Granted Royal Assent[52]

Bill C-25, *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the* ITA *and to make a consequential amendment to another Act*,[53] received Royal Assent on December 14, 2006. Some of the most important amendments in Bill C-25 that are applicable to charities and their legal counsel are amendments that will:

(1) Bolster client identification, record-keeping and reporting measures applicable to financial institutions and intermediaries;

(2) Allow the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") to disclose additional information, to both domestic and foreign law enforcement and intelligence agencies;

(3) Allow CRA to disclose to FINTRAC, RCMP and the Canadian Security Intelligence Service information about charities, including identifying information of the charities' directors and officers suspected of being involved in terrorist financing activities;

(4) Exempt lawyers from reporting obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.[54]

a) Increase in Sources and Type of Information Collected

With Bill C-25's expansion of reporting entities, virtually any means of transmitting funds (i.e. banks, money order businesses, securities dealers) used by a charity may result in reports being

[51] For additional background information, see Esther S.J. Oh and Terrance S. Carter, “"Political Activities: What Churches and Charities Can and Cannot Do" in *Church Law Bulletin* No. 15 (15 December 2005) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[52] For more information, see Terrance S. Carter and Sean S. Carter, "Unprecedented Due Diligence Standards Emerge for Charities Internationally" in *Anti-Terrorism and Charity Law Alert* No. 9 (July 17, 2006) online: http://www.carters.ca/pub/alert/ATCLA/index.htm, Terrance S. Carter, "Canadian Charities: The Forgotten Victims of Canada's Anti-Terrorism Legislation" in *Anti-Terrorism and Charity Law Alert* No. 10 (September 20, 2006) online: http://www.carters.ca/pub/alert/ATCLA/index.htm, and Terrance S. Carter & Sean S. Carter, "New Anti-Terrorist Financing Law Has Direct Impact for Charities" in *Anti-Terrorism and Charity Law Alert* No. 12 (January 24, 2007) online: http://www.carters.ca/pub/alert/ATCLA/index.htm.

[53] Parliament of Canada, Bill C-25, online: www2.parl.gc.ca/HouseBills.

[54] S.C. 2000, c. 17.

made to FINTRAC. In several situations, a charity may find itself being subject to reporting obligations under the amended Act.

Bill C-25's amendments have also significantly expanded the nature of the information concerning the transaction and the parties involved. The *Proceeds of Crime Act* refers to this information, which is retained for up to five years, as "designated information," which may potentially be disclosed to both foreign and domestic government agencies.

Most pertinent to charities that transfer funds domestically and internationally is Bill C-25's expansion of designated information to include "the name, address, electronic mail address and telephone number of each partner, director or officer" of the charity and "any other similar identifying information." As such, a charity's directors and officers are now explicitly central to the anti-terrorism vetting that is being carried out by private sector financial service providers and government agencies. In light of this, vetting should now correspondingly be central to a charities' own due diligence procedures concerning its directors and officers and those of recipient organizations.

This information is now being checked against substantial international anti-terrorism financing lists as a result of Bill C-25. For example, the revised *Proceeds of Crime Act* now directly refers to the *Regulations Implementing the United Nations Resolutions on the Suppression of Terrorism*, which includes lists of hundreds of individuals and entities. In addition, under section 65(1) of the *Proceeds of Crime Act*, as amended by Bill C-25, FINTRAC is specifically authorized to enter into agreements with foreign governments in order that FINTRAC may send and receive designated information between foreign agencies. Bill C-25 excludes "designated donor information," which has a limited definition, from information that is to be shared with other agencies and foreign governments.

b) Expanding the Recipients of Information and the Impact for Charities

One of the more pernicious amendments included in Bill C-25 is that much of the information to be sent to FINTRAC is based on an assessment of a "suspicion" of "attempted" acts of terrorist financing. Some likely scenarios that could result in an unwitting charity falling victim to the broad, all encompassing grounds to disclose information include: the recipient organization having a director who is suspected of having ties to supporting terrorism unbeknownst to the recipient organization; transferring funds for humanitarian aid to organizations working in "conflict areas"; or a financial institution used by the recipient organization in a transfer having been identified as complicit in some acts of supporting terrorism.

The reports detailing "suspicious" transactions that are sent to FINTRAC and passed on to various government agencies could have potentially disastrous consequences for a charity. These reports could be the basis for "facilitation" of terrorism charges under section 83.19 of the *Criminal Code*; potentially initiate the de-registration process under the *Charities Registration (Security Information) Act* ("*Charities Registration Act")*; or even result in personal liability for the directors and officers of a charity. Even an initiation of an investigation under anti-terrorism provisions could lead to seizure or freezing of charitable property and immeasurable damage to public perception and donor confidence.

What raises the spectre of being investigated under suspicions of contravening anti-terrorism legislation is not only the expansion of the information being collected and retained by FINTRAC, but the burgeoning domestic and foreign sources to which this information is being disclosed. For example, the grounds to disclose information to CRA have become very broad under the Bill C-25 amendments. Under section 55 of the *Proceeds of Crime Act*, the "designated information" would be disclosed to CRA if there where grounds to even "suspect" that the information is relevant to maintaining its charitable status. In addition, reports will be sent to CRA now if the information is potentially relevant to determining an application for charitable status. Once the report of suspicion reaches CRA, this information could essentially quash an organization's application for charitable status or result in the launching of an investigation under the de-registration process. Under the Bill C-25 amendments, the expanded designated information could also be disclosed to the Canada Border Services Agency, Canadian Security Intelligence Service ("CSIS") and Communications Security Establishment.

c) Changes to the ITA

The increasing monitoring and oversight of charities that is enabled by Bill C-25 is also plainly evident in its amendments to the ITA. The amendment to subsection 241(4) of the ITA significantly expands the scope of inter-agency information sharing concerning the enforcement of the *Charities Registration Act.* The amendments to the ITA also includes an addition to subsection 241(8) that allows CRA officials to freely disclose a variety of information about a charity to the RCMP, CSIS and FINTRAC that would be relevant to investigations under the terrorist activity and facilitation provisions of the *Criminal Code*.

The type of information that can now be disclosed to other agencies like the RCMP and CSIS under the amendments to the ITA includes "designated taxpayer information," a newly created and defined term. The expansive scope of designated taxpayer information includes the name, addresses and citizenship of current and former directors, trustees, agents and employees of a charity or applicant for charitable status. This designated taxpayer information also includes information available in broadly defined "commercially available databases."

Though Bill C-25 was introduced by the government to purportedly comply with international obligations, specifically those promulgated by the Financial Action Task Force ("FATF"), the legislation goes far beyond requirements of the broad and general international commitments. Many have noted that Canada, which is currently serving as the head of the FATF, is eager to demonstrate a "tough line" on terrorist financing to the global leaders of the war on terror, predominantly the United States and the United Kingdom.

2. New Draft Regulations Bring Lawyers Under the Purview of Terrorist Financing Laws[55]

The proposed "Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (2007-2)" ("Draft Regulations") that were published on June 30, 2007, is the most recent initiative by the federal government to bring legal counsel under the direct purview of terrorist financing obligations.[56]

If adopted, the impact of the Draft Regulations will be felt throughout the legal community and will necessitate a restructuring of legal counsel's procedures concerning advising clients on monetary transactions and the development of internal anti-terrorism due diligence procedures.

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[55] For more information, see Terrance S. Carter and Sean S. Carter, "Closing the Gaps: New Draft Regulations Bring Lawyers Under the Purview of Terrorist Financing Laws" in *Anti-terrorism and Charity Law Alert* No. 14 (July 31, 2007) online: http://www.carters.ca/pub/alert/ATCLA/index.htm.

[56] Canada Gazette, "Regulations Amending Certain Regulations Made Under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (2007-2)" at http://gazetteducanada.gc.ca/partI/2007/20070630/html/regle6-e.html.

a) The *Proceeds of Crime Act* and the Legal Profession

The federal government had previously repealed the application of the *Proceeds of Crime Act* to the legal profession in response to concerns from the legal community and a constitutional challenge brought by the Federation of Law Societies of Canada (the "Federation"). The primary concern for the legal profession at the outset was the threat to the independence of the Bar by requiring lawyers to secretly report confidential client information to the government with respect to suspicious transactions, and to report large cash transactions to FINTRAC.[57]

Negotiations between the Department of Finance and the legal profession have been ongoing since 2002 in order to develop a mutually acceptable regime of reporting and due diligence procedures. In May 2005, the matter between the Federation of Law Societies of Canada ("the Federation") and the Attorney General of Canada was adjourned *sine die* (without any future date being designated for resumption) and upon a number of conditions by the British Columbia Supreme Court.[58]

The amendments to the *Proceeds of Crime Act* by Bill C-25 confirmed that lawyers were exempt from reporting obligations under the *Act*. The potential scope of obligations and liability, however, under the *Proceeds of Crime Act* is sweeping and is not confined to reporting obligations. It was not perhaps unexpected that in June of this year that the Department of Finance published the Draft Regulations that propose to recruit the legal profession to participate in the federal anti-terrorist financing initiative while being careful to avoid overtly requiring counsel to be subject to reporting obligations.

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[57] The Law Society of British Columbia, "What's New" http://www.lawsociety.bc.ca/utilities/whatsnew.html.

[58] *Federation of Law Societies of Canada v. Attorney General of Canada* (British Columbia Supreme Court, Vancouver Registry No. L013117, 13 May 2005). The conditions include the following:

- That if a new set of regulations affecting legal counsel is enacted pursuant to the *Proceeds of Crime Act* by the Federal Government without the consent of the Federation, that the coming into force of those regulations would be deferred in accordance with the May 2002 Agreement between the Federation and the Attorney General of Canada;
- That the Attorney General of Canada agree to interlocutory injunctions exempting legal counsel and legal firms from the application of the Act and its Regulations should it become necessary to maintain the status quo at any stage of the proceedings; and
- That the Federation and the Attorney General have an unrestricted right to re-set the petition for hearing.

b) 'Closing the Gap': The Draft Regulations

The importance of the Draft Regulations to the federal government and its determination to see the legal profession brought under the purview of terrorist financing regulations cannot be understated. The Department of Finance was clear in its "Regulatory Impact Analysis Statement" ("Impact Statement") that accompanied the publication of the Draft Regulations, the legal profession is one of the final sectors that it intends to bring within the purview of the *Proceeds of Crime Act* and thus "closing the gaps" in Canada's anti-terrorist financing regime.[59] In addition, the Draft Regulations could be adopted as soon as the end of this year, as they were only subject to a 60-day consultation period, which came to a close on August 29, 2007.

The Department of Finance, in response to its obligation not to subject the legal profession to reporting requirements, has proposed to require that lawyers meet the client identification and record-keeping requirements under Part 1 of the *Act*. Under the Draft Regulations, lawyers will be required to carry out procedures for confirming the identity of certain clients and to undertake risk assessments to assess the risk of being utilized by clients for terrorist financing.

The responsibilities of legal counsel and legal firms under the Draft Regulations would be generally triggered whenever counsel, on behalf of a client, engages in or gives instructions in respect of "receiving or paying funds, other than those received or paid in respect of professional fees, disbursements, expenses or bail" unless the amount is received through a financial entity or public body. Though the language of this portion of the Draft Regulations is vague, presumably this would mean that responsibilities under the *Act* could apply when counsel is involved in a variety of activities including: the purchase or sale of property; receiving or dispersing of judgments and/or settlement funds; or the administration of an estate.

The Department of Finance stressed in its Impact Statement that it consulted with "professional associations" at certain stages of the development of the Draft Regulations over the past few years. However, in describing the various sources for the actual recommendations that are implemented in the Draft Regulations, the Impact Statement credits "several of the federal partners to the regime" including the RCMP and the Canada Revenue Agency.

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[59] Supra, note 60.

The enforcement and penalties of the Draft Regulations range from being asked to complete questionnaires, on-site investigations by FINTRAC, financial penalties of up to $500,000 under the *Proceeds of Crime Act*, and punishment under the *Criminal Code*. The on-site investigation raises the possibility of a threat to solicitor-client privilege that may arise from the prospect of a government agency with oversight being able to audit lawyer's internal compliance procedures.[60] Furthermore, investigations under the *Proceeds of Crime Act* could lead to an investigation under the broad scope of the *Criminal Code* facilitation of terrorist activities provision. Even an investigation based on the suspicion of a terrorist activity facilitation offence could – at the very least - result in the freezing or seizure of the assets of a lawyer or law firm, actions which would cripple a practice for months or even years.

c) New Compliance Regime and Due Diligence Burden

If adopted, the Draft Regulations would have significant implications for how lawyers conduct their practice in order to implement the strict client verification, risk assessments and record keeping procedures. The Department of Finance's Impact Statement recognizes that the practical implications of the Draft Regulations for lawyers and law firms would include conducting a risk assessment as to the "vulnerabilities" to be used for terrorist financing of the law firm, training employees on the implementation of anti-terrorist financing policies and appointing a compliance officer.

In order to assist with keeping lawyers in compliance with the Draft Regulations[61], the Federation has developed model rules[62] to be adopted and implemented by individual law societies across the country. The most recent model rule focuses on client identification and verification requirements imposed by the Draft Regulations. The Federation has requested that all Canadian law societies consult with their members and provide feedback in order to help to inform the final draft of the model rule and assist the Federation in its ongoing discussions with the Department of Finance on the Draft Regulations.

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[60] Cristin Schmitz, Lawyers Weekly "Lawyers and government spar over new money-laundering rules" Vol. 27, No. 12, July 20, 2007.

[61] *Supra* note 60.

[62] The Federation has developed a "No Cash Rule" which has now been adopted in one form or another by every law society in Canada, forming part of their professional conduct rules. The Federation is also in the process of developing a "Client Identification Rule". However, the draft has not yet been finalized as it is still in the consultation stage of development.

It is important to note that even without the adoption of the Draft Regulations, legal counsel and their clients are already subject to scrutiny under the *Proceeds of Crime Act* (s. 7 and s. 7.1). Under the *Act*, all financial institutions that actually process and carry out any monetary transactions are already responsible to report certain transactions to FINTRAC, confirming the identities of the parties and analyzing the transaction for any signs of activity that would raise suspicions about terrorist financing.

3. Report released from the Special Senate Committee on the *Anti-Terrorism Act*[63]

On February 22, 2007 the Senate Special Committee on the *Anti-terrorism Act* issued its main report entitled "Fundamental Justice in Extraordinary Times: Main Report of the Special Senate Committee on the *Anti-Terrorism Act"* available at: http://www.parl.gc.ca/39/1/parlbus/commbus/senate/com-e/anti-e/repe/rep02feb07-e.htm. The Committee, formed in December 2005, had been holding hearings since April 2006 and had undertaken a "comprehensive review of the provisions and operation of the *Anti-terrorism Act*, (S.C.2001, c.41)". The Committee made a variety of recommendations concerning aspects of Canada's antiterrorism legislation including:

- removing the motive requirement from the *Criminal Code* definition of "terrorist activity"
- legislating a single definition of terrorism for federal purposes
- appointing a 'special advocate' to challenge the allegations against a party, and argue in favour of the disclosure of information, in anti-terrorism-related proceedings where the party does not have full access to the evidence
- extending the 'investigative hearings' and 'preventative arrest' provisions of the *Criminal Code* until the end of the fifteenth sitting day of Parliament after December 31, 2009.

The report also upheld the perceived utility and need for the current anti-terrorist financing laws and the deregistration process for charities under the *Charities Registration Act*.

[63] Sean S. Carter in *Charity Law Update*, February 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html.

4. Major Changes to Anti-Terrorism Laws Recommended By House of Commons Subcommittee Report[64]

The final report of the House of Commons Subcommittee on the Review of the *Anti-terrorism Act* ("House Subcommittee") was published on March 27, 2007. Unlike the report from the Special Senate Committee, this report appeared to show the first echoes of acknowledgement from Parliament of the distressing reality that charities face under this legislation.

a) Recommended Changes to the *Charities Registration (Security Information) Act*

Among the recommendations of the House Subcommittee's report are substantial changes to the *Charities Registration Act*, which was created by the *Anti-Terrorism Act* ("ATA") and outlines the process of issuing of a "certificate" by which a charity can be deregistered. In order to remedy some of the deficiencies in the law surrounding the deregistration process and bring clarity with respect to the due diligence burden that charities face, the House Subcommittee has recommended changes including:

- "Due Diligence" defense for charities facing deregistration:
- Creation of "Best Practice" guidelines for Canadian charities:
- Institution of a knowledge (*mens rea*) requirement:
- Right to Appeal a Finding of Reasonableness

b) Other Recommended Changes Impacting Charities

There are several other recommended legislative changes that would impact charities in the House Subcommittee's report. One of these recommendations is the establishment of a "Panel of Special Counsel" to test the need for confidentiality and closed hearings, as well as to test the evidence not disclosed to a party in proceedings. The Panel of Special Counsel would participate in proceedings surrounding the establishment of "listed entities," the deregistration process under the *Charities Registration Act,* and the security certificate process under the *Immigration and Refugee Protection Act*[65].

The House Subcommittee also recommends that section 145 of the ATA be amended to require another comprehensive review of its provisions and operation, to be commenced no later than

[64] Terrance S. Carter & Sean S. Carter, "Major Changes to Anti-Terrorism Laws Recommended By House of Commons Subcommittee Report" in *Anti-Terrorism and Charity Law Alert* No. 13 (April 18, 2007) online: http://www.carters.ca/pub/alert/ATCLA/index.htm.

[65] S.C. 2001, c. 27

December 31, 2010. While the recommended changes briefly touched on by this article are a significant step forward for charities, there are many other recommendations of a general scope from the House Subcommittee that are potentially of concern to charities, including the recommended creation of a new *Criminal Code* offence for the "glorification of a terrorist activity for the purpose of emulation."

5. Proposed New Auditing Requirements Under the *Corporations Act* (Ontario)[66]

On December 12, 2006, Bill 152 (the *Ministry of Government Services Consumer Protection and Service Modernization Act, 2006*)[67] received Third Reading in the Ontario Legislature. It received Royal Assent on December 20, 2006 and came into effect on August 1, 2007. The *Corporations Act* (Ontario)[68] is one among many provincial statutes to be amended by this Bill. The *Corporations Act* (Ontario) is to be amended so that all non-share capital corporations, including charitable corporations, with an annual income of less than $100,000 will no longer require an audit. The Explanatory Notes for Bill 152 with respect to the amendments of these subsections provide as follows: "The Bill amends the audit requirements of the Act. At present, a company is exempt from the audit requirements only if its annual income is less than $10,000. Under section 96.1 of the Act, this threshold is increased to $100,000. Under section 133 of the Act, charitable corporations will be entitled to the same exceptions from the audit requirements of the Act as other companies."[69] These amendments to the *Corporations Act* (Ontario) will be welcome news for smaller provincially incorporated charitable and not-for-profit organizations that have limited funds and cannot afford the expense of a yearly audit.

6. Ministry of Government Services consultation paper on reform to the *Corporations Act* (Ontario)[70]

The Ontario Ministry of Government Services ("Ministry") released its first consultation paper on reform to the *Ontario Corporations Act*[71] ("OCA"). This consultation paper, *Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations,*[72] marked the Ministry's

[66] Paula J. Thomas in *Charity Law Update*, December 2006 at p. 5, online: http://www.carters.ca/pub/update/charity/index.html.
[67] Legislative Assembly of Ontario, online: www.ontla.on.ca/documents/Bills/38_Parliament/session2/index.htm.
[68] R.S.O. 1990, c. C-38.
[69] Legislative Assembly of Ontario, online: www.ontla.on.ca/documents/Bills/38_Parliament/session2/b152rep.pdf.
[70] For more information, see Jacqueline M. Demczur, "Comments on a Consultation Paper for Reform of the Corporations Act (Ontario)" in *Charity Law Bulletin* No. 120, (July 31, 2007).
[71] R.S.O. 1990, c. C.38.
[72] Available online at: http://www.gov.on.ca/MGS/graphics/132791.pdf.

first step in a project that aims to develop a new framework for governing the structure and activities of charities and not-for-profit corporations in Ontario. The consultation paper focuses on a number of broad issues, each of which the Ministry has provided background information and consideration questions for.

a) The Need for Reform

The primary basis for proposing reform to the OCA was concern that the OCA is antiquated, cumbersome, and unable to meet requirements of the modern not-for-profit sector. It is hoped that reform to the OCA will both achieve modernization of the Act and facilitate a legal structure that equates with the actual needs of today's not-for-profit organizations.

b) The Incorporation Process

As an alternative to the current system, the Ministry has proposed that the new Act might provide organizations with the ability to incorporate "as of right". Under this process, applications for incorporation would be automatically approved once basic requirements for incorporation are established. This would limit the scope of the Ministry's review and would also allow the incorporation process to proceed quickly.

To integrate an "as of right" system, the Ministry will be required to determine what the basic requirements of incorporation should be and how to apply an "as of right" system to charitable not-for-profit organizations. They must also take on the difficult task of determining to what extent the new Act should be concerned with the objects and powers of a corporation. This consideration will require extreme mindfulness as to how reform may influence the current legal requirements for maintaining a charitable purpose.

c) The Structure of the OCA

The current Act is difficult to navigate and its structure requires replacement. These difficulties have led the Ministry to propose two potential models for a new structure: The Ontario *Business Corporations Act* ("OBCA") or the *California Corporations Code* ("CCC").

Structurally, the OBCA is very logical. Section by section it follows the chronology of a corporation and the central issues that need to be addressed by corporate legislation (e.g. incorporation, membership, directors and officers, remedies). The OBCA did form the structural basis for proposed *Canada Not-for-profit Corporations Act* ("Bill C-21"), which, however, was unsuccessful in receiving Parliament's support. Further, the OBCA structure is designed for business corporations and could be criticized as less suitable to the needs of not-for-profit corporations.

The CCC is what might be described as 'divided legislation'. It contains various sections for various designated types of not-for-profit corporations and in each section it addresses all things relevant to that type of corporation. While the CCC model is user-friendly, it is also quite lengthy. Further, under a CCC model, problems can arise in determining how to the different corporations should be classified.

As can be seen, neither model is totally suitable for the new Act to follow. As well, there may be other potential models that are not listed in the consultation paper that may be more appropriate to utilize. It is possible that the Ministry will ultimately find that they should combine the best features of various models in order to meet the unique needs of not-for-profit organizations in Ontario.

d) Defining the Term "Not-For-Profit Corporation"

The consultation paper divides the framework for examining the definition of 'not-for-profit corporation' into two separate components: not-for profit purposes and non-distribution constraints. Not-for profit purposes refer to the requirement that not-for-profit corporations pursue purposes other than profit or pecuniary advantage to their members. Non-distribution constraints refer to the nature of not-for-profit corporations as being different from business or commercial entities, in that they do not distribute property to their members.

- Not-for-profit purposes

  As suggested, the current Act permits a not-for-profit organization to become incorporated with any objects within the jurisdiction of Ontario and requires not-for-profit corporations to be carried on without the purpose of gain for its members. What is problematic about the current Act is that the term 'gain for members' has no clear meaning and it has been interpreted to permit the incorporation of associations that indirectly advance the pecuniary interest of their members by advancing a common interest (e.g. trade associations).

In its reform, the Ministry is considering a more clearly defined list of permitted purposes and activities. It is further considering the explicit exclusion of any form of gain to members. In making these considerations, the Ministry must consider how the new Act should regulate the degree of for-profit activities that not-for-profit corporations are permitted to carry out. They must also consider whether exceptions to the restrictions on for-profit activity should be provided to certain corporations.

- Non-Distribution Constraint

  Currently, the OCA specifies that a not-for-profit corporation must carry its operations on without the purpose of gain for its members. However, the wording of the OCA is not so explicit so as to provide a non-distribution constraint. In fact, the OCA has been interpreted as allowing certain corporations the distribution of assets to corporate members upon dissolution. Of course, charitable not-for-profit corporations are prohibited from distributing funds to their members, which creates some confusion in relation to this aspect of the current Act. The Ministry will be required to examine other available non-distribution constraint techniques to determine how the new Act can best to approach the ability of not-for-profit corporations to distribute assets.

e) Classification System

The current Act only provides for one class of not-for-profit corporation, being a class which is made up of corporations whose objects are within the jurisdiction of the Province of Ontario. Reform to the OCA has called into question whether Ontario not-for-profit corporations would be better served if the OCA took their diversity into account and categorized them into several different classes and regulated each class according to their common features. The CCC model takes a similar approach.

The Ministry must determine if a class model is desirable and, if it is, they must evaluate a variety of different classification models that could be used. The Saskatchewan *Non-Profit Corporations Act*[73] categorizes not-for-profit corporations as either charitable corporations or membership corporations, and then more stringently restricts the ability of charitable corporations to make fundamental changes to its object and distribution clause. Bill C-21

73 1995, S.S. 1995, c. N-4.2 at s. 2(9) and (10).

distinguished between soliciting corporations and non-soliciting corporations, with soliciting corporations being more heavily regulated because they are corporations that solicit funds from the public, government or other entities. The CCC classifies corporations as mutual benefit, public benefit or religious, with public benefit corporations being the most heavily regulated.

The Ministry has already proposed certain areas where different classes of corporations might be treated differently. They suggest that the distribution of assets on dissolution, the payment of remuneration to directors, and members' rights and remedies are, for example, areas where differences between not-for-profit corporations may require that organizations are regulated differently.

Distinguishing between corporations in the manner proposed does seem at first glance somewhat logical. Not-for-profit corporations can vary tremendously from one corporation to another and a regulatory system that looks to those differences may better address specific corporate needs. Yet this classification of not-for-profit corporations could also foster a regulatory regime that forces corporations to fit into a specific class description without properly considering how that exact corporation should be regulated. This is particularly of potential concern for religious corporations. .Possibly an alternative approach to a classification system would involve having certain provisions that apply to all corporations, together with optional provisions that could be chosen to customize particular corporations depending upon their intended purposes and activities.

f) Corporate Powers and Capacity

Under the current Act, a not-for-profit corporation has the capacity of a natural person and the ability to exercise its powers outside of Ontario. The OCA, however, prescribes that a corporation's ability as a natural person can be limited by the OCA or the bylaws of the corporation. This preserves the doctrine of *ultra vires* which declares that actions of a corporation that are beyond its power will be considered void.

Many other corporate statutes that regulate both business and not-for-profit corporations have abolished this doctrine of *ultra vires*. Rather than making actions void if they are committed outside of corporate power, these statutes simply make the actions illegal and subject to general legal sanctions.

The Ministry has not proposed that the doctrine of *ultra vires* will be absolutely abolished. It has, however, raised several questions, the answers to which may outline the benefits and drawbacks of maintaining this doctrine. Given the recent trend for the abandonment of the doctrine by other corporate legislation, it is likely that the doctrine of *ultra vires* will not form a part of the new Act.

g) Other Relevant Issues and Considerations

The Ministry's consultation paper also raises questions surrounding the nature of the reform as it will pertain to the more specific topic of directors' and officers' liability, financial disclosure and members' remedies. It suggests that more detailed papers will be released on these topics but, as a preliminary measure, feedback is invited.

- Directors' and Officers' Liability

  The current Act sets out no duty of care, standard of care or defences that are applicable to the directors and officers of not-for-profit corporations. The Ministry notes that the not-for-profit sector often experiences difficulty in recruiting and retaining qualified individuals to fill these positions. The current lack of attention that this topic receives under the OCA opens directors and officers to personal liability in a number of ways and thus serves as a deterrent to individuals who might otherwise wish to accept a director or officer position within a not-for-profit corporation.

  The Ministry will be required to create a liability regime that takes into account the need for directors and officers to be treated fairly, while still being accountable to those who suffer losses as a result of the actions of a director, officer, or corporation.

- Financial Disclosure

  The current Act has specific requirements for financial disclosure but it does not require financial disclosure to the public or to the members of the corporation. Although some corporations are required to provide this financial disclosure because of Canada Revenue

Agency requirements, the Ministry must determine if there is a level of financial disclosure that should be required of all not-for-profit corporations.

- Members' Remedies

  Although the current Act does provide several remedies for members of not-for-profit corporations, it does not provide for an oppression remedy, a derivative action, the right to dissent and appraisal, or provisions for a fair hearing and natural justice. The Ministry is attempting to determine whether these remedies should be extended to members of not-for-profit corporations and whether, in addition to introducing new remedies, the current remedies should be broadened or altered.

On August 22, 2007, in light of the important role of Directors and Officers of charities and not-for-profit corporations, the Ministry released a second discussion paper[74], under the same name, focusing on various subjects in relation thereto. The second paper raises questions and makes recommendations pertaining to board composition, term of office, delegation of powers, directors meetings, directors and officer's liability, conflicts of interest and resignation, removal and vacancies. Additional discussion papers will be forthcoming throughout this review reform initiative undertaken by the Ministry.

7. *Trustee Act* (Ontario) to Govern the Investment of Proceeds Under the *Charitable Gifts Act* (Ontario)[75]

On May 17, 2007, Bill 187, the *Budget Measures and Interim Appropriation Act, 2007*, S.O. 2007, c. 7, received Royal Assent. Affected is section 6 of the *Charitable Gifts Act*, R.S.O. 1990, c. C.8, which deals with the investment of proceeds. That section is being re-enacted by removing the reference to the *Insurance Act*, R.S.O. 1990, c. I.8, and replacing it with references to the *Trustee Act*, R.S.O. 1990, c. T.23. The purpose of doing so is that any monies resulting from the mandatory sale of an interest in a business in accordance with section 2 of the *Charitable Gifts Act* (Ontario) will need to be invested in accordance with the prudent investor standard set out in section 27 of the *Trustee Act* (Ontario) instead of in accordance with the investment provisions in the *Insurance Act* (Ontario). Specifically, section 6 now reads that:

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[74] Available online at: http://www.gov.on.ca/MGS/graphics/166168.pdf

[75] Paula J. Thomas in *Charity Law Update*, May/June at p. 6, online: http://www.carters.ca/pub/update/charity/index.html.

"The proceeds of any disposition pursuant to section 2 may be invested only in investments authorized under sections 27 to 31 of the *Trustee Act*, but no such investment shall be made that results in the person making the investment holding more than a 10 per cent interest in any one business." The *Budget Measures and Interim Appropriation Act, 2007* is expected to be proclaimed into force later this year. That date is subject to the date on which section 15 of Schedule O of Bill 151, the *Budget Measures Act*, 2006 (No. 2), S.O. 2006, c. 33, comes into force. Schedule O amends the *Insurance Act* and the *Corporations Act*, R.S.O. 1990, c. C.38. Bill 151 received Royal Assent on December 20, 2006.

8. Recent CRTC Changes: Telemarketing and The National Do Not Call List[76]

The Canadian Radio-Television and Telecommunications Commission ("CRTC") has laid the foundation for Canada's first national do-not call list and provided further clarification and modification of the telemarketing rules established by Telecom Decision 2004-35 with the release of Telecom Decision CRTC 2007-48.[77] Although registered charities obtained a legislated exemption from the National Do-Not-Call List ("National DNC list"), directors, CEOs and legal counsel to those organizations and other charities and not-for-profit organizations will have to make themselves aware of the new telemarketing regime, which includes the requirement of individual do-not-call lists that are separate and distinct from the National DNC list and from which there is no exemption.

The telemarketing rules established by Decision 2004-35 brought about a number of restrictions, including restrictions on unsolicited live voice and fax calls made for the purpose of solicitation, requiring self-identification, prohibitions against sequential dialling and restrictions on calls to emergency lines and healthcare facilities, among others. There was no exemption from these rules. Decision 2004-35 also discussed the potential for a National DNC list in general, but the potential for this was dismissed because there was no legislative basis for the CRTC to have any capacity for its enforcement. This was remedied by the passing of Bill C-37 (S.C. 2005, c. 50), which granted the CRTC powers to establish and enforce a National DNC list, as well as providing an exemption from the National DNC list for charitable organizations registered under

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[76] For more information, see Terrance S. Carter & Nancy E. Claridge, "Charities, Telemarketing and The National Do Not Call List: An Update On Recent CRTC Changes" in *Charity Law Bulletin* No. 119, (July 30, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[77] Decisions 2004-35 and 2007-48 can be viewed at: http://www.crtc.gc.ca.

s. 248(1) of the ITA (Canada). Implementation of the telemarketing rules was stayed following applications by organizations like the Association of Fundraising Professionals ("AFP") for the decision's review and variance.

AFP raised several specific concerns about the burdensome impact that the telemarketing rules could have on charitable organizations. AFP requested that the CRTC vary Decision 2004-35 to exempt charitable organizations from the telemarketing rules, submitting that they failed to strike a reasonable balance between the charitable sector's need to raise funds efficiently and the public's need to be free from undue intrusions.

In reviewing the decision, the CRTC focused their attention on the establishment of a National DNC list, possible reforms to the telemarketing rules, and the need for an investigation of complaints process for the violation of both the National DNC list and the telemarketing rules.

For telemarketers in general, the most relevant portion of Decision 2007-48 was the establishment of rules and guidelines for a National DNC list. The purpose of this list is "to provide consumers with an effective and efficient means of preventing unwanted telecommunications from as many telemarketers or clients of telemarketers as possible." The rules and guidelines for the National DNC list have the potential to severely restrict the current abilities of telemarketers throughout Canada, but will not be implemented until an independent operator has been selected. In accordance with Bill C-37, the CRTC exempted registered charities from the National DNC list rules. However, this exemption does not extend to non-registered charities or the non-registered affiliates of registered charities or to not-for-profit organizations, who will need to become familiar with the rules.

In Decision 2007-48, the CRTC assessed the appropriateness of each of the telemarketing rules introduced in Decision 2004-35. This assessment was done in light of the introduction of a National DNC list and the newly assigned powers of the CRTC, as well as submissions from the public. Although several organizations submitted that certain parties, including registered charities should be exempt from all telemarketing rules, the CRTC refused to accept these submissions. They specifically noted that their definition of solicitation has always included charities that solicit for cash donations, donations of goods and volunteer time, and stated that "consumers do not consider telemarketing made by or on behalf of charities to cause any less undue inconvenience and nuisance, or to be less of an invasion of privacy, than telemarketing made by or on behalf of for-profit organizations."

Although the CRTC relaxed a number of the telemarketing rules, i.e. eliminating the need to provide a unique registration number to consumers requesting to be added to the organization's do-not-call list, removing the requirement for a toll-free number to be manned during business hours, varying the requirement that the telemarketer immediately provide identification before any other communication and before asking for the desired individual, among others, the rules remain a significant burden on the organizational and funding capacity for charitable and not-for-profit organizations. What will likely be a source of confusion for many registered charities is the requirement under the telemarketing rules for each organization to maintain its own do-not-call list even though they may be exempted from the National DNC list.

Guidelines for handling consumer complaints about the violation of the telemarketing rules were also outlined in Decision 2007-48. Although the chosen National DNC list operator will manage the actual filing of complaints, the CRTC will maintain the roles of investigator and issuer of notices of violation and monetary penalties.

The denial of an exemption to the telemarketing rules for charitable organizations that solicit donations is an obvious disappointment to the charitable sector, and means that charities and their boards of directors should review and implement the rules to avoid the possibility of a consumer filing a complaint leading to a notice of violation or a monetary penalty.

E. RECENT CASE LAW AFFECTING CHARITIES

1. Meaning of Charity and Gift

a) Supreme Court of Canada Confirms the Common Law With Respect to Charity and Sports Organizations[78]

The Supreme Court of Canada has unanimously upheld the Federal Court of Appeal's decision that an Ontario amateur youth soccer association does not qualify as a registered charity within

[78] For more information, see Karen.J. Cooper & Terrance S. Carter, "Supreme Court of Canada Confirms the Common Law With Respect to Charitable Sports Organizations" in *Charity Law Bulletin* No. 126 (October 17, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

the meaning of subsection 248(1) of the *Income Tax Act* ("ITA"). Writing for the majority, Justice Marshall Rothstein concluded that although some sports organizations, other than registered Canadian amateur athletic associations ("RCAAAs"), might be found to be charities under the common law, the appellant did not qualify for charitable registration because its purposes and activities were not charitable. The majority judgment confirms the existing common law with respect to the determination of what is charitable in the context of sports organizations, indicating that recognition of an organization, such as the appellant, would result in a significant change to the common law beyond the incremental changes mandated by the jurisprudence and would be best left to Parliament.

- Background

A.Y.S.A. Amateur Youth Soccer Association (the "Corporation") is a federally incorporated not-for-profit corporation, the purpose of which is to promote the sport of soccer in Ontario. The Letters Patent of the Corporation specifically provide as follows:

i) to fund and develop activities and programs to promote, organize and carry on the sport of amateur youth soccer;

ii) to fund, promote and develop local amateur youth soccer programs and coaching appropriate to different age groups and different levels of ability to increase participation in the sport of soccer;

iii) to raise funds for facilities and equipment necessary to achieve the foregoing objects in ways the law regards as charitable;

iv) to receive gifts, bequests, funds and property and to hold, invest, manage, administer and distribute funds and property for the objects of the Corporation; and

v) to conduct activities and exercise such powers as are necessary for the achievement and furtherance of the objects of the Corporation.

The Corporation applied to be a registered charity as defined in subsection 248(1) of the ITA. In its application for charitable status, the Corporation identified that the activities it would undertake to further its objects would include soccer practice, competition, and skills development camps for both youth and coaches. CRA rejected the application for charitable registration on the basis that the promotion of sport is not recognized as a charitable purpose at common law and that since the Corporation's overall purpose is to promote the sport of soccer it did not qualify for registration.

The Corporation appealed CRA's decision to the Federal Court of Appeal. The Corporation's main argument focused on language in an Ontario court decision, *Re Laidlaw Foundation*,[79] ("Re *Laidlaw*") which held that the promotion of amateur sport involving the pursuit of physical fitness is a charitable purpose. The Corporation argued that since the common law in Ontario recognizes the promotion of amateur sport as a charitable purpose and the proposed activities are confined to Ontario, the law of Ontario should apply to the determination of its charitable status.

The Federal Court of Appeal[80] did not deal with the issue of whether or not amateur sport could be considered charitable. Instead, it focused on the provisions of the ITA which provide specific tax exemptions for registered Canadian amateur athletic associations ("RCAAAs"). The definition of a RCAAA found in subsection 248(1) of the ITA requires that the association promote amateur athletics on a national level and that the association qualify as a non-profit corporation in accordance with paragraph 149(1)(l) of the ITA. The Federal Court of Appeal held that there was no need to have recourse to the common law of Ontario, since the ITA provides for the tax status of the Corporation and this particular tax status precludes the possibility of its being registered as a charitable organization.[81] The Court found that in providing for the status of a RCAAA in 1972, "Parliament must be taken to have been aware that no association which has, as its main purpose, the pursuit of amateur sport could qualify as a charity under the common law, and hence, under the Act."[82] The Court concluded that the scheme of the ITA precludes the possibility of an amateur sport organization being registered as a charity.[83] Based on the analysis of the Federal Court of Appeal, because the Corporation is an amateur athletic association which operates exclusively in Ontario, it is not only precluded from the tax-exempt status conferred on RCAAAs, but it is also precluded from becoming a registered charity pursuant to subsection 248(1) of the ITA.

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[79] (1984), 13 D.L.R. (4th) 491 at 506 and 523-24 (Ont. H.C.J.). [*Re Laidlaw]*
[80] *A.Y.S.A. Amateur Youth Soccer Association v. Canada Revenue Agency* (2006), 267 D.L.R. (4th) 724 (F.C.A.).
[81] *Ibid.* at para. 13.
[82] *Ibid.* at para. 20.
[83] *Ibid.* at paras. 22-23.

The Corporation appealed to the Supreme Court of Canada, which appeal was heard on May 16, 2007. The decision of the Supreme Court of Canada was rendered on October 5, 2007.[84]

- Summary of Decision

The appellant claimed that its purposes and activities were charitable on the basis of the fourth head of charity established in *Pemsel*[85] and most recently commented upon by the Supreme Court of Canada in *Vancouver Society of Immigrant and Visible Minority Women,*[86] ("*Vancouver Society*"): other purposes beneficial to the community in a way the law regards as charitable. While much of the English case law supports the contention that "mere sport" is not charitable, the appellant's main argument focused on language in *Re Laidlaw*,[87] which supports a view that the promotion of amateur sport involving the pursuit of physical fitness could be considered a charitable purpose. The appellant argued that "the time is ripe for Canadian courts to recognize that the promotion of amateur sports involving the pursuit of physical fitness fits under the final *Pemsel* category … the time has come for sport to stand on its own."[88] Since the common law in Ontario recognizes the promotion of amateur sport as a charitable purpose and the proposed activities are confined to Ontario, the appellant argued that the law of Ontario should apply to the determination of its charitable status. Further, on the basis of section 8.1 of the *Interpretation Act*,[89] provincial law must be applied to the determination of what is charitable under the ITA and that the relevant provincial law was established in *Re Laidlaw.*

The government's submissions focused on maintaining the Federal Court of Appeal decision, arguing that there was no need to have recourse to the common law of Ontario, since the RCAAA provisions of the ITA occupy the field for amateur sports associations and expressly preclude the possibility of such an organization being registered as a charitable organization. In support of this submission, the government cited various

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[84] *A.Y.S.A. Amateur Youth Soccer Association* v. *Canada (Revenue Agency)*, 2007 SCC 42.
[85] *Commissioners for Special Purposes of the Income Tax* v. *Pemsel*, [1891] A.C. 531 (H.L.).
[86] *Vancouver Society of Immigrant and Visible Minority Women* v. *M.N.R.*, [1999] 1 S.C.R. 10 at para. 176.
[87] *Supra* note 79.
[88] *Supra*, note 84 at p. 23.
[89] R.S.C. 1985, c. I-21.

passages from *Hansard*, which it claimed suggests that Parliament's intent when it amended the ITA in 1971 was to exclude sports associations other than RCAAAs from the tax benefits of charitable status. The respondent argued that any interpretation of the ITA provisions related to charity must recognize Parliament's express intention not to include the promotion of sport as charitable.

Justice Marshall Rothstein, writing for a majority of eight of the nine judges, chose to first deal with the issue of whether the existence of the RCAAA provisions of the ITA preclude amateur sports organizations from being registered as charities and concluded that they do not. Justice Rothstein did not accept the government's arguments that Parliament's intention in this regard was evident from the cited passages of *Hansard* and states that the passages do not

> … evince a parliamentary intent to freeze the development of the common law on charitable status or to occupy the field for all amateur sports. Neither does the fact that RCAAAs can channel funds to their regional member organizations necessarily support the view that any other non-affiliated sports organizations were intended to be absolutely excluded from charitable status. The ITA continued to leave the definition of what is "charitable" to be determined by reference to the common law.[90]

The majority decision of the Court then examined the text of the ITA provisions related to RCAAAs and charities and cautioned against interpretations which rely on implied meaning, concluding that:

> Neither the text nor scheme of the Act, nor the legislative purpose in establishing the RCAAA regime suggest that the RCAAA provisions preclude charitable status for non-nationwide sports organizations of all sorts or all descriptions. Rather, Parliament created a clear position for RCAAAs, and left the rest to be determined in accordance with the long-standing practice under the common law.[91]

[90] *Supra* note 84 at p. 14.
[91] *Ibid.* at p. 16.

It is with respect to this issue of whether the existence of the RCAAA provisions expressly precludes the possibility of the appellant in this instance becoming a registered charity that the ninth judge, Justice Rosalie Abella, differed from her colleagues. In concurring reasons, Justice Abella found that the RCAAA provisions clearly excluded non-national sports organizations from receiving the tax benefits of charitable status:

> The concept of "charity" may be a unique beast in the *Income Tax Act*, but it is nevertheless a caged one. The cage in this case is the RCAAA statutory scheme. Those provisions explicitly confer charity-like benefits only on amateur athletic associations with a national focus. Parliament's intention to exclude all other amateur athletic associations could hardly be clearer. In view of this explicit statutory directive, there is no need to seek clarification from the common law.[92]

However, since majority decision determined otherwise, Justice Rothstein then proceeded with an analysis of the law with respect to the determination of whether a sports organization may be considered charitable at common law. The Court restated a number of principles with respect to this determination established in *Vancouver Society*, highlighting Justice Iacobucci's comments with respect to the movement of the common law with respect to charities and agreeing that, when considering an expansion of the definition of charity, the Courts must consider whether what is being proposed is an incremental change or one with such complex ramifications it should be left to Parliament.[93] The majority decision then aptly summarized the analysis to be undertaken:

> To summarize, in determining if an organization is charitable under the fourth head of *Pemsel* for purposes of registration under the ITA, it will be necessary to consider the trend of cases to decide if the purposes are for a public benefit which the law regards as charitable. It will also be necessary to consider the scheme of the ITA. Finally, it is necessary to determine whether what is sought is an incremental change or a reform best left to Parliament.[94]

[92] *Ibid.* at p. 32.
[93] *Ibid.* at p. 21.
[94] *Ibid.* at p. 22.

Considering the specific argument of the appellant that sport should stand on its own as a specific category of charitable activity within the fourth head of charity, Justice Rothstein examined various relevant English decisions and *Re Laidlaw*. The majority decision distinguished the *Re Laidlaw* decision on the basis that the Court in that case was considering the meaning of charitable in a particular statutory context, section 6 of the Ontario *Charities Accounting Act*,[95] which did not include the common law restriction with respect to the fourth head that the purpose of the organization must be recognized by the common law as charitable. This is contrary to the interpretation mandated with respect to the application of the ITA in *Vancouver Society,* which clearly establishes that public benefit alone is not sufficient to qualify under the fourth head and that the Courts must look to the jurisprudence to determine whether the particular purposes fit within the established categories of charity or a category analogous thereto.[96] In that regard, Justice Rothstein confirmed that "[t]he case law supports the proposition that sport, if ancillary to another recognized charitable purpose, such as education, can be charitable, but not sport in itself."[97]

With respect to consideration of the scheme of the Act, Justice Rothstein reaffirmed the distinction in the ITA identified by Justice Iacobucci in *Vancouver Society* between registered charities and non-profit organizations and the principle derived therefrom that the scheme of the ITA clearly anticipates that not all non-profit social welfare activities should be considered charitable.[98]

Finally, the Court notes that, with respect to the question of whether what is being proposed by the appellant is an incremental change, the government submitted that 21% of all non-profit organizations in the country are sports and recreation organizations and that acceding to the appellant's argument would have a significant impact on the income tax system. Justice Rothstein agreed with the government stating that "this would seem to be closer to

[95] R.S.O. 1990, c C.10.
[96] *Supra* note 84 at pp. 25-26.
[97] *Ibid.* at p. 3.
[98] *Ibid.* at p. 28.

wholesale reform than incremental change, and is best left to Parliament… substantial change in the definition of charity must come from the legislature rather than the courts."[99]

- Commentary

The Supreme Court of Canada's decision in *A.Y.S.A.* does not establish any new principles of law. Instead, it merely confirms the existing common law as it relates to the question of whether particular sports organizations may be recognized as registered charities. Unlike the Federal Court of Appeal decision, the majority decision leaves open the possibility that a sports organization may become registered as a charity, provided that sport is ancillary to another recognized charitable purpose. However, this possibility is nothing more than a statement of what is already clearly recognized in practice, since any activity by a charity will be acceptable if it is a means of achieving a recognized charitable purpose. For instance, developing skills in swimming that assist disabled children will be acceptable for a registered charity to undertake, not because swimming as a sport is charitable at common law, but because the objective of assisting disabled children is an acceptable charitable purpose. The real issue is whether sports in and of itself can be seen as a charitable purpose at common law under the fourth head.

In this regard, it is noteworthy that the Court indicates that it is "sympathetic to the proposition that organizations promoting fitness should be considered charitable"[100] but that the facts of the case before it did not even establish that the purpose of the organization was the promotion of physical fitness. This suggests that with better facts and perhaps a less drastic impact on the tax system, the Court might be persuaded that an incremental expansion of the law which recognizes limited sports activities might be possible. Undoubtedly, CRA will continue to interpret the law strictly in the meantime and only recognize organizations whose sports activities are ancillary to other recognized charitable purposes at common law, such as advancement of education or relief of poverty.

The Court also reaffirms the view that any significant changes to the definition of charity will need to come from Parliament, a clear indication that the Supreme Court of Canada has no interest, particularly in light of the facts before it this case, to be interventionist in this

[99] *Ibid.* at pp. 28-29.
[100] *Ibid.* at p. 27.

regard. As such, the issue of reform to the definition of charity will need to change forum from the courts to Parliament given the limitations of what the Supreme Court of Canada is prepared to do.

b) Promotion of "Ethical Tourism" Not Considered Charitable[101]

On May 3, 2007, the SCC dismissed the application for leave to appeal by the appellant in *Travel Just v. Canada Revenue Agency*, 2006 F.C.A. 343. On October 24, 2006, the FCA had released its decision in this case,[102] representing an important decision concerning what is considered to be charitable at common law. This case involved the refusal by CRA to register a charity with the object "to create and develop model tourism development projects that contribute to the realization of international human rights and environmental norms." The FCA concluded that the organization's objects were "vague and subjective" and were not sufficiently analogous to purposes already recognised by the Courts under the fourth category of charity: other purposes beneficial to the community. In addition, the language left open the possibility of the organization financing and operating luxury holiday resorts, activities with a strong commercial and/or private benefit aspect. The FCA also indicated that there was no evidence of a connection with Québec, noting that the issue of whether an organization is charitable for the purposes of the ITA is likely a public law concept, rendering the private law of Québec irrelevant, thus avoiding a decision on this issue.

2. Regulation of Charities

a) CRA Audits of Registered Charities[103]

The SCC granted the appellant's application for leave to appeal in *Redeemer Foundation v. Minister of National Revenue*, 2006 D.T.C. 6712 (F.C.A.) on May 10, 2007 and is tentatively scheduled to hear the appeal on February 28, 2008. In this case, the FCA considered the process CRA must follow to obtain the names of donors during the course of an audit of a registered charity. After having audited a charity that operated a "forgivable loan program," CRA obtained

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[101] For more information, see Karen J. Cooper and Terrance S. Carter, "Promotion of Ethical Tourism Not Considered Charitable" in *Charity Law Bulletin* No. 105 (December 19, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[102] *Travel Just v. Canada Revenue Agency,* [2006] F.C.J. No. 1599.

[103] Karen J. Cooper in *Charity Law Update*, May/June 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html and Karen J. Cooper in *Charity Law* Update, October 2006 at p. 6, online: http://www.carters.ca/pub/update/charity/index.html; See also *All Saints Greek Orthodox Church v. Minister of National Revenue*, [2006] F.C.J. No. 481.

from the charity, upon a verbal request, donor information with which CRA contacted the donors to advise them that they would be reassessed to disallow the donation tax credits claimed for their donations to the charity. After providing the list of donors to CRA, the Foundation brought an application in the Federal Court ("FA") for judicial review of the auditor's request on the basis that the auditor should have followed the process provided for in subsection 231.2(2) of the ITA requiring prior judicial authorization. The initial decision of the FA declared that the actions of the auditor were unlawful and ordered that the reassessments of the donors be vacated. This decision was appealed by CRA, and the FCA overturned the initial decision on the basis that there were other provisions in the ITA authorizing the auditor to make the request that he did and to use that information for the purposes of subsequent tax assessments. Specifically, subsection 231(2) of the ITA requires charitable organizations to maintain certain records, including duplicates of all receipts, and section 231.1 of the ITA authorizes an auditor to examine the organization's books and records. The FCA concluded that if an auditor is entitled to obtain the information and compile the list of donors by his own examination of the books and records of the organization, there is no reason for the auditor to have to resort to the process established in subsection 231.2(2) of the ITA.

b) Court Says "Place of Worship" Property Tax Exemption Should Be Strictly Construed[104]

In refusing to exempt a convent property from payment of property taxes, Ontario's Superior Court of Justice has said that for public policy reasons, the exemption for a "place of worship" under the *Assessment Act* (Ontario) should be strictly construed. In its decision in *Holy Theotokos Convent v. Whitchurch-Stouffville* (Town), [2007] O.J. No. 542 (Sup. C.J.), the court confirmed that the proper test to apply in determining whether an exemption under the *Assessment Act* applies is the "primary purpose test." In other words, the party seeking the exemption must show that the primary or dominant purpose for which the property is being used is exempted under the *Assessment Act*. To establish the primary use of the entire property as a place of worship, the cloistered order relied on the evidence that the Sisters share a communal existence with an emphasis on a contemplative prayer life. For example, one prayer is repeated 6,000 times during the day in virtually every corner of the property. Although the Municipal Property Assessment Corporation conceded the two chapels and the baptistery fell within the

[104] Nancy E. Claridge in *Charity Law Update*, March 2007 at p. 4, online: http://www.carters.ca/pub/update/charity/index.html.

exemption, the question of whether the remainder of the property was also entitled to be exempt from property taxes was at issue. In denying the exemption, the court held that the exemption "does not apply to the worship activities confined solely to the devotional life of members of a religious order whether that includes group or individual worship or prayers for the convent members. The exemption does apply to places of worship inside the convent grounds open to members of the public for some formal worship services."

c) Are Camp Fees subject to G.S.T.?[105]

In *Camp Mini-Yo-We Inc.v. H.M.Q.*[106], released December 18, 2006, the FCA considered whether fees charged by a religious camp were subject to the G.S.T. As a general rule, the *Excise Tax Act*, R.S.C. 1985, E-15, exempts most services offered by charities from the application of the G.S.T. This appeal deals with an exception to that rule: namely, the supply by a charity of any "service involving supervision or instruction in any recreational or athletic activity." The appellant submitted that because of the evangelical Christian character of the camp and its programs the exception does not apply. In addition, it could be argued that the fee was paid for two services, the religious component and the recreational component, and that providing the recreational component was "incidental" to the overall religious purpose of the services and, therefore, exempt on this basis.

The Court determined that the religious, athletic and recreational services were too closely intertwined for separate fees to be charged and the incidental supply rules to apply. As a result, registered charities that operate camps for children and youth that include supervision or instruction in any recreational or athletic activity should consider charging G.S.T. unless they fall within further exceptions to the exception above related to day camps or camps for "individuals who are underprivileged or who have a disability."

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[105] Karen J. Cooper in *Charity Law Update*, January 2007 at p. 3, online: http://www.carters.ca/pub/update/charity/index.html.

[106] 2006 F.C.A. 413.

d) Khawaja Decision Affords Little Relief for Charities[107]

Since the first wave of anti-terrorism legislation was declared in force in late 2001, its impact has loomed large over Canadian charities and their foreign operations. The case of Mohammad Momin Khawaja, the first person to be charged under the core "terrorism" provisions in Part II of the *Criminal Code*, presented the first chance to judicially review this controversial law. In *R. v. Khawaja*[108], Mr. Justice Rutherford of the Ontario Superior Court of Justice struck down a portion of the definition of "terrorist activity" in the *Criminal Code* that dealt with purpose and motive. The decision, released on October 24, 2006, was met with mixed reviews by anti-terrorism legal commentators, some of whom initially heralded the case as a powerful blow to draconian legislation. However, the impact upon Canadian charities, which are particularly vulnerable to the sweeping "facilitation of terrorist activity" provision in section 83.19 of the *Criminal Code*, is not encouraging. The decision offers charities little relief from their susceptibility to unintentional contravention of the law because the court decided to uphold the legislation notwithstanding its breadth and the limited mens rea requirement concerning the definition of "facilitation". As a result, there are significant risks that a charity involved in conducting aid or humanitarian programs in a conflict area could unwittingly be found to still have facilitated a terrorist activity.

e) Supreme Court Strikes Down Security Certificates[109]

In a unanimous decision of the SCC on February 23, 2007, Canada's controversial procedure for determining the reasonableness of security certificates and the detention review procedure, the substance of which has been a fixture in immigration law for well over a decade, and which predates the bulk of Canada's anti-terrorism legislation enacted since the fall of 2001, was held to contravene the *Canadian Charter of Rights and Freedoms*. In making this decision, Chief Beverly McLachlin, writing for the Court in *Charkaoui v. Canada (Citizenship and Immigration)*, 2007 SCC 9 ("*Charkaoui*"), confirmed that "the right to a fair hearing comprises the right to a hearing before an independent and impartial magistrate who must decide on the facts and the law, the right to know the case put against one, and the right to answer that case."

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[107] For more information, see Terrance S. Carter and Sean S. Carter, "Khawaja Decision Affords Little Relief for Charities", in *Anti-Terrorism and Charity Law Alert No. 11* (December 20, 2006) online: http://www.carters.ca/pub/alert/ATCLA/index.htm.
[108] [2006] O.J. No. 4245.
[109] Nancy E. Claridge in *Charity Law Update*, February 2007 at p. 3, online: http://www.carters.ca/pub/update/charity/index.html.

But the secrecy required by the certificate and detention review was found to deny the person named in a certificate the opportunity to know the case put against him or her, and hence to challenge the government's case. Although the procedure for the judicial approval of certificates was held to be of no force or effect, the Court suspended the declaration for one year in order to provide the federal government the opportunity to respond.

The *Charkaoui* decision is a promising condemnation of the government's anti-terror laws and may provide some hope for charities that might find themselves facing a similar process under the *Charities Registration Act* (the "Act"), which was enacted under Part VI of the *ATA*. Under this Act, the government can revoke the charitable status of an existing charity or deny a new charitable status application if it is determined that the charity has supported or will support terrorist activity. Among the many criticisms of the review process under the Act, is the ability of the government to introduce evidence which the impugned charity is not able to know or challenge. Similar to the criticism in *Charkaoui*, the secrecy undermines the reviewing judge's ability to come to a decision based on all the relevant facts and law. Despite the promise given in *Charkaoui*, charities who are exposed to the Act's deregistration process will have to wait for future litigation focused on the Act's procedures to see if similar principles of fundamental justice will apply to an organization's charitable status as it does to the detention of individuals.

3. Directors' Liability and Governance

a) Non-Share Capital Corporations Must Strictly Adhere to Corporate Governance Procedures[110]

Rexdale Singh Sabha Religious Centre v. Chattha, a decision originally released by the Ontario Superior Court of Justice on January 24, 2006,[111] involved a dispute over the corporate governance procedures of three inter-related non-share capital corporations. The three charitable organizations appealed the application judge's order to fix the membership of the three corporations as set out in an affidavit of one of the respondent directors, as well as to require the existing directors to convene a meeting within 30 days to elect new directors by means of a fair

[110] For more information, see Terrance S. Carter and Paula J. Thomas, "Non-Share Capital Corporations Must Strictly Adhere to Corporate Governance Procedures in *Charity Law Bulletin* No. 101 (October 27, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.html, and "Court of Appeal Update on Corporate Governance Compliance" in *Charity Law Bulletin* No. 106 (December 20, 2006) online: http://www.carters.ca/pub/bulletin/charity/index.html.
[111] [2006] O.J. No. 328.

vote. The Ontario Court of Appeal decision was released on November 27, 2006,[112] allowing the appeal. In the Court's opinion, there had been a failure to properly change the members of the corporation in accordance with the *Corporations Act* (Ontario), and that the application judge had incorrectly concluded that four of the five directors of Rexdale were permitted to have approved the creation of a list of new members. As well, the Court of Appeal held that where proper election of directors has not occurred, the initial incorporators would continue to be the first directors of the corporation. While the courts came to different conclusions, both decisions illustrate that non-share capital corporations must adhere as strictly to corporate governance procedures as for-profit corporations.

b) Non-Share Capital Corporations Must Interpret By-Laws Fairly, Reasonably and in Good Faith[113]

Chu v. Scarborough Hospital Corp.,[114] a decision released by the Ontario Superior Court of Justice on December 28, 2006, involved a dispute between Lai Chu ("Ms. Chu"), an annual member of the Scarborough Hospital (the "Hospital"), and the Hospital's board of directors (the "Board"). The decision of Justice David Brown canvassed a number of provisions of the *Corporations Act* (Ontario) (the "Act"),[115] the statute under which many Ontario charitable and not-for-profit organizations incorporate. The interpretation of by-laws, the calling of special meetings, classes and terms of membership, and the Hospital's governance structure were all considered in the trial decision. In granting Ms. Chu's application, an order was made for the Hospital's membership to run for a full twelve months and for the Board to call a general meeting of the Hospital's membership, to be held no later than January 31, 2007.

The Hospital appealed the order to the Ontario Divisional Court (the "Divisional Court") pursuant to section 329 of the Act and requested that the order be set aside. The appeal was heard on March 26, 2007 and the decision was released on July 7, 2007[116].

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[112] [2006] O.J. No. 4698.

[113] Terrance S. Carter & Paula J. Thomas, "Non-Share Capital Corporations Must Interpret By-Laws Fairly, Reasonably and in Good Faith" in *Charity Law Bulletin* No. 110, (February 21, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html, and Terrance S. Carter & Paula J. Thomas, "Ontario Divisional Court Update on Fair and Reasonable Interpretation of By-Laws" in *Charity Law Bulletin* No. 118, (July 30, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

[114] [2006] O.J. No. 5147.

[115] R.S.O. 1990, c. C.38.

[116] *Chu v. Scarborough Hospital Corp.*, Divisional Court File No. 009/07, Court File No. 06-CU-323276PD1, July 6, 2007.

The Divisional Court concluded that the "[trial] decision involved a legal interpretation of the [Act] as well as the Hospital's by-laws and the application of that interpretation to the very specific facts of this case … and hence the standard of review [was] that of palpable and overriding error."[117]

The appeal turned on whether Ms. Chu's request to the Board to call and hold a special meeting was valid. In that regard, the Divisional Court had to determine whether she was an approved annual member at the time she made the said request. At trial, it was held that she was, in fact, an approved annual member at that time, and as such her request for a special meeting was legitimate. The manner in which the Board had been interpreting the annual member class of membership caused a length of service of only four or five months. Both the trial judge and the Divisional Court agreed that this was not a correct interpretation of the by-laws and was, in fact, unfair and unreasonable. An annual membership should be exactly that: a membership which ran for a period of a full twelve months.

The Divisional Court quoted Justice Brown's sound admonishment of the Board's actions in noting paragraph 42 of the trial decision:

> The Board has not acted fairly towards the Hospital's Approval Annual Members. It has construed its powers to appoint such members and to amend the Hospital's by-laws. In addition, the Board cannot on the one hand adopt a by-law amendment that by its very language created a reasonable expectation that Approved Annual Members would have meaningful input into the governance review process and resulting by-law amendments, and then dash those expectations by removing the item from the agenda and relying on a highly formalistic position that the memberships of the Approved Annual Members had evaporated. The evidence paints the picture of a Board interpreting the Hospital's by-laws in an unreasonable way that places complete control of governance matters in the hands of the directors and negates any meaningful role for Approved Annual Members.

The Divisional Court concluded that there was no palpable and overriding error in the trial judge's decision. While the Divisional Court agreed with the appellant's submission that the Act neither refers to "Annual Members" as a category of membership, nor mandates one which runs

[117] *Ibid.* at para. 6.

for a full year, a unilateral interpretation by the Board of this category of membership pursuant to the Hospital's by-laws was not reasonable. The Hospital's By-law No. 1 indicated that the role of the annual members was "to act as a check and balance to the powers of the Board of Directors" and as such it was "not reasonable that [the Board] should in its sole discretion be able to determine unilaterally the duration of such Memberships from year to year or from event to event." In the Divisional Court's view, the "annual membership" category had to be given "ordinary and plain language meaning, namely that such memberships would run for a full year."[118]

Notwithstanding the dismissal of the appellant's appeal, the Divisional Court concurred with one of the Hospital's arguments, in that the case law plainly establishes the following:

> [t]he by-laws of non-share capital corporations incorporated pursuant to the *Corporations Act*, like the case at bar, constitute contractual obligations as between the members and the corporation (see *Senez v. Montreal Real Estate Board*, [1980] 2 S.C.R. 555 (S.C.C.), QL p. 7 and *Sahayadakivski v. YMCA*, [2006] O.J. No. 1368 (S.C.J.), paras. 28-30). Both the corporation and individuals who become members of the corporation undertake to comply with the constating documents and the by-laws, which are duly adopted by a majority of members entitled to vote, even if they disagree with those by-laws.[119]

Furthermore, the Divisional Court also agreed that jurisprudence indicates that the courts are not to interfere with decisions made by a non-share capital corporation pursuant to its by-laws, provided that such decisions are not made in bad faith or in contravention of the rules of natural justice. However, in this case, the word "annual" had been interpreted by the Board in an unfair manner. At trial and on appeal, both courts agreed that "annual" means a full year of twelve months.

c) Corporation’s Right to Regulate Qualifications of Directors120

Although courts have traditionally expressed reluctance to interfere in the internal affairs of associations and clubs, in *Rakowski v. Malagerio* (2007), 84 O.R. (3d) 696 (Sup. C.J.), a judge of

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[118] *Ibid*., at para. 18.
[119] *Ibid.* at para. 20.
[120] For more information, see Nancy E. Claridge and Terrance S. Carter, “Court Upholds Corporation’s Right to Regulate Qualifications of Directors” in *Charity Law Bulletin* No. 121, (July 31, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

the Ontario Superior Court of Justice concluded, in a decision released on February 1, 2007, that the court has jurisdiction to intervene in the affairs of an incorporated student federation in order to determine if a policy prohibiting members of other student associations or student advocacy groups from serving on the board of directors was unreasonable, discriminatory, inconsistent with the objects of the corporation, contrary to the *Canadian Charter of Rights and Freedoms* and the *Corporations Act* (Ontario), and passed in bad faith. The court concluded that since the impugned policy was enacted to prevent conflicts of interest, it was neither objectionable on its face, nor was it discriminatory, contrary to public policy or public interest and did not interfere with *Charter* rights.

d) Decision is Warning to Sham Corporations[121]

A related Ontario appeal decision released on September 6, 2007, has provided useful guidelines for determining when the corporate veil can be pierced, leaving directors liable for costs in litigation. In reversing a lower court decision, the Ontario Court of Appeal in *The St. James' Preservation Society v. Toronto (City)*, 2007 ONCA 601, suggested that the determination that The St. James' Preservation Society (the "Society") was a sham or "man of straw" corporation resulting in the individual directors being held liable for court costs in excess of $100,000 was premature and required a full hearing on the costs issue. Instead, the Court of Appeal concluded that the individual members of the Society did not receive adequate warning in this case that costs would be sought against them personally and that the exceptional circumstances did not exist for a personal costs award to be made against them.

Although the Court of Appeal did not find the exceptional circumstances present to warrant a personal costs award against Currie and Grange in this case, the decision serves as a warning for others who seek to use the non-share capital corporation for the purposes of avoiding liability associated with their public interest litigation activities. The decision does not preclude a finding by the courts that individuals that are pursuing personal interests through a sham corporation will be held liable for costs on a personal basis, whether or not the litigation can be characterized as frivolous or vexatious or an abuse of process. In this regard, the decision suggests that organizations incorporated for the purpose of pursuing a public interest need to address a number

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[121] For more information, see Terrance S. Carter and Nancy E. Claridge, "Decision is Warning to Sham Corporations" in *Charity Law Bulletin* No. 123 (September 25, 2007) online: http://www.carters.ca/pub/bulletin/charity/index.html.

of issues prior to engaging in costly litigation in order to protect directors from potential personal liability, including ensuring the following:

- the organization has a genuine interest in the outcome of the litigation. A history of activity by the organization related to the public interest issue may help demonstrate this interest;
- the organization is not acting to vindicate a private interest, and the individual directors do not stand to gain personally from the litigation;
- the litigation involves novel issues that have not previously been interpreted by the courts and are not the subject of settlements; and
- no other potential litigants would be better suited to bring the litigation.

As the Court of Appeal noted, if these factors are present, it takes the litigation out of the realm of an abuse of process, a basis upon which the court may award costs personally against individual directors.

F. CONCLUDING COMMENTS

The past 12 months have brought a number of significant changes to the area of charity law which will be of particular concern for the directors and officers of charities, as well as for their legal counsel. The number of legislative changes, CRA policy initiatives and CRA rulings that have occurred during the past 12 months, as well as the release of numerous significant decisions from the courts, underscore how complicated the law pertaining to charitable organizations has become in Canada. It is therefore important for practitioners in this area to keep abreast of developments in the law as they occur.