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CHARITY LAW UPDATE FOR ESTATES AND TRUSTS PRACTITIONERS: THE YEAR IN REVIEW

(Current as of October 30, 2009)

Terrance S. Carter
Carters Professional Corporation

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Table of Contents

A. INTRODUCTION 1
B. OVERVIEW OF CHARITABLE SECTOR 2
C. RECENT LEGISLATIVE. INITIATIVES UNDER THE *INCOME TAX ACT* 4
1. 2009 Federal Budget 4
2. Possible Disbursement Quota Reform 5
D. NEW GUIDANCES, COMMENTARIES AND OTHER PUBLICATIONS FROM CANADA REVENUE AGENCY 6
1. 3.5% Disbursement Quota Extended to All Charitable Organizations 6
2. New T2050 Application Form for Charitable Status 7
3. Introduction of New T3010B Annual Information Return 8
a) Overall Structure of the Forms 9
b) Directors/Trustees and Like Officials 9
c) Programs and General Information 10
d) Financial Information 12
e) Summary Comments 13
4. CRA Introduces Anti-Terrorism Checklist 13
a) Not Sufficient Context for Charities 15
b) Potential Undue Sense of Simplicity 16
c) Continued Delegation 16
d) Excessive Recommendations 17
e) Summary Comments 18
5. CRA Releases Policy Commentary on Requests for Disbursement Quota Relief 18
6. CRA Releases a Policy and Guidance on Sports and Charitable Registration 19
7. CRA Proposed Guidance on the Protection of Human Rights and Charitable Registration 20
a) Human Rights and the Four Heads of Charity 21
b) The Importance of Understanding Political Purposes and Activities 23
8. CRA's New Guidance on Fundraising 24
a) Fundraising in the Charitable Context 25
b) Definition of Fundraising and Other Terms 25
c) Prohibited Fundraising Conduct 25
d) Allocation of Fundraising Expenditures 25
e) Evaluation of Fundraising Activities 26

f) Areas of Continuing Concern ... 28
g) Summary Comments ... 29
9. CRA's Proposed New Guidance for Charities Operating Outside Canada ... 30
a) Use of Intermediaries ... 30
b) "Own Activities" Test ... 32
c) Other Considerations ... 33
d) Summary Comments ... 34
E. RECENT TECHNICAL INTERPRETATIONS AND DECISIONS UNDER THE *INCOME TAX ACT* ... 35
1. Donating the Temporary Use of a Cottage is Not a Gift ... 35
2. Split Receipting for Cemetery Plots ... 36
3. Federal Court of Appeal Decides Operating a Hostel not Charitable ... 37
4. Gifts of Marketable Securities – Enduring Property? ... 37
5. Gift of Capital Property by Will ... 38
6. Valuation of Gifts of Life Insurance – update ... 39
7. Directed Gift to Municipality ... 40
8. Gifting Artwork ... 40
9. Clarification by CRA on Enduring Property for Purposes of the Disbursement Quota ... 41
10. Charity Deregistered for Carrying On an Unrelated Business Activity ... 46
11. CRA Withdraws Compliance Agreement ... 47
F. OTHER FEDERAL LEGISLATION AFFECTING CHARITIES ... 48
1. Update on New Not-for-profit Canada Corporations Act ... 48
2. Proposed Consumer Product Safety Act ... 50
G. ONTARIO LEGISLATION AFFECTING CHARITIES ... 50
1. Ontario Corporate Update ... 51
2. Bill 212, Good Government Act 2009, Proposed Reforms to Legislation Concerning Charities ... 51
3. Ontario Public Guardian and Trustee Releases Advice on Fundraising ... 53
H. CONCLUDING COMMENTS ... 55

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A. INTRODUCTION

The law of charities has always been an important area of practice for estates and trusts practitioners, whether it be with regard to drafting *inter vivos* or testamentary charitable gifts, administering estates which include gifts to charities, or advising trustees or boards of directors concerning the operations of a charity. As such, it is useful for estates and trusts practitioners to keep abreast of current developments in the law of charities.

As recently as 15 years ago, changes in the law with regard to charities over the course of a year would usually consist of a few court decisions involving testamentary charitable gifts or denials of charitable registration, an occasional new policy from CRA, or possibly some type of legislative initiative from the Department of Finance included in a federal budget. Now, however, there is scarcely a month that goes by that there is not either a new policy or publication from CRA on an important area of compliance for charities, a decision by CRA revoking the charitable status of a charity for some egregious reason, or possibly a Federal Court

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[*] Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is managing partner of Carters Professional Corporation, and counsel to Fasken Martineau DuMoulin LLP on charitable matters. During the last 12 months, Terrance S. Carter and other lawyers at Carters Professional Corporation (Specifically, Karen J. Cooper, Theresa L.M. Man, Jacqueline M. Demczur, Jane Burke-Robertson, Esther S.J. Oh, Donald J. Bourgeois, and Nancy E. Claridge) have published numerous articles in *Charity Law Bulletins* and in *Charity Law Updates* of the firm (available at www.charitylaw.ca), as well as in *The Lawyers Weekly*, *Charity Talk* (Canadian Bar Association), *Charitable Thoughts* (Ontario Bar Association), *Canadian Fundraiser* and *The Bottom Line*. Portions of these articles have been incorporated into this paper as a compilation, and as such, the author would like to acknowledge and thank the other authors at Carters for their contributions. As such, this paper is therefore very much a combined effort by the lawyers at Carters. The author would also like to acknowledge and thank Ryan M. Prendergast, an articling student at Carters, for his assistance in the compilation and editing of this article, Sean S. Carter for his assistance concerning articles related to anti-terrorism law, as well as Jennifer A. Schwass for the thankless task of proofreading.

of Appeal decision usually confirming an earlier CRA decision to revoke or annul the charitable status of a charity.

In this regard, the charitable sector in Canada has seen a number of important regulatory and common law developments over the past 12 months at both the federal and provincial level which will have a significant impact on how charities operate. To this end, this paper provides an overview of some of the more important of these recent developments, including changes under the *Income Tax Act*[1] ("ITA"), new Policies, Guidances, Commentaries and other publications from the Charities Directorate of the Canada Revenue Agency[2] ("CRA"), technical interpretations from CRA, decisions of the Federal Court of Canada, as well as other federal and provincial legislative initiatives affecting charities, including the proposed repeal of the *Charitable Gifts Act*[3] and the proposed changes to the *Charities Accounting Act*[4] that were just introduced on October 27, 2009. For those readers who would like more details concerning any of the topics discussed below, reference to source documents and other resource materials are included throughout the paper.

B. OVERVIEW OF CHARITABLE SECTOR

Before embarking on a review of recent developments in charity law, it would be helpful to first provide some context by providing a brief overview of the current state of the charitable sector in Canada. In this regard, CRA published a helpful report in November 2008 entitled *Small and Rural Charities: Making a Difference for Canadians*[5] which indicated that in 2007 there were over 83,000 registered charities in Canada, which in 2006 spent $111.8 billion in carrying out their charitable programs.[6] Of these registered charities, it is interesting to note that 40% fell under the head of advancement of religion for their charitable purposes. In comparison, the report noted that there were 81,000 not-for-profit organizations operating in Canada. The report also indicated that the voluntary sector in Canada employs about 2 million full time workers, or

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[1] R.S.C. 1985, c. 1 (5th Supp.), as amended.
[2] Charities Directorate of Canada Revenue Agency, online: http://www.cra-arc.gc.ca/tx/chrts/menu-eng.html.
[3] R.S.O. 1990, c. C.8.
[4] R.S.O. 1990, c. C.10.
[5] Available on the CRA website at: http://www.cra-arc.gc.ca/E/pub/tg/rc4457/rc4457-e.html.
[6] For more information, see Terrance S. Carter, "Highlights of CRA's Report on Small and Rural Charities" in *Charity Law Bulletin* No. 149 (November 27, 2008) online: http://www.carters.ca/pub/bulletin/charity/2008/chylb149.pdf.

7.2% of Canada's working population. This figure is roughly equivalent to the mining, construction, oil and gas industries combined, and does not include colleges, universities or hospitals, which would otherwise cause the number to increase dramatically.

A separate survey published in June 2009 by Statistics Canada, entitled *Caring Canadians, Involved Canadians: Highlights from the 2007 Canada Survey of Giving, Volunteering and Participating* ("the 2007 Survey"),[7] reported that in the twelve-month period covered by the 2007 Survey, almost 23 million Canadians, or 84% of the population, made a financial donation to a charitable or non-profit organization. The 2007 Survey reported that the total amount donated in 2004 was $8.9 billion, which increased by 12% in 2007 to $10 billion. With respect to the beneficiaries of these donations, the 2007 Survey reported that religious organizations accounted for 46% of the total dollar value of donations. The 2007 Survey also reported that nearly 12.5 million Canadians, or 46% of the population, volunteered during the twelve-month period covered by the 2007 Survey, with 2.1 billion volunteer hours being volunteered. The major beneficiaries of these volunteers were organizations involved in sports and recreation, social services, education and research, and religion.[8]

A further report concerning the charitable sector was released on October 19, 2008 by the Muttart Foundation entitled *Talking about Charities 2008: Canadians' Opinions on Charities and Issues Affecting Charities* ("the Muttart Report").[9] The Muttart Report noted that 77% of Canadians not only trust charities, but also the leaders of charities. Respondents in the Muttart Report placed their trust in the leaders of charities second only to nurses and medical doctors. However, the Muttart Report also identified areas in which charities could improve, particularly with regard to transparency about where charitable money and donations are spent.[10]

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[7] Michael Hall *et al*., *Caring Canadians, Involved Canadians: Highlights from the 2007 Canada Survey of Giving, Volunteering and Participating* (Ottawa: Statistics Canada, 2009). Available online at http://www.givingandvolunteering.ca/files/giving/en/csgvp_highlights_2007.pdf.

[8] See also Terrance S. Carter, "Report On the 2007 Canada Survey On Giving, Volunteering And Participating" in *Charity Law Bulletin* No. 173 (September 28, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb173.pdf.

[9] The full report can be found online at: http://www.muttart.org/sites/default/files/downloads/TAC2008-03-CompleteReport.pdf.

[10] See also Terrance S. Carter, "What Canadians Think About Charities: Highlights of Muttart's 'Talking about Charities Report'" in *Charity Law Bulletin* No. 152 (December 19, 2009) online: http://www.carters.ca/pub/bulletin/charity/2008/chylb152.pdf.

These various reports collectively indicate that the charitable sector in Canada is one that continues to grow in importance and financial resources. Despite concerns regarding the transparency of charitable organizations, the public continues to trust and look to the charitable sector for the provision of essential services for their communities.

C. RECENT LEGISLATIVE. INITIATIVES UNDER THE *INCOME TAX ACT*

The following is a brief overview of some of the more important legislative incentives that have occurred with regard to the ITA over the last 12 months.

1. 2009 Federal Budget[11]

Although there has been much activity from CRA over the past year concerning the administration of charities, the 2009 Federal Budget ("the Budget"), released on January 27, 2009, was noticeably devoid of any significant legislative developments concerning the regulation of charities with regard to either tax incentives or technical amendments. The exception to this were a few minor amendments with regard to refining provisions concerning the excess business holding rules for private foundations.[12]

Unfortunately, the budget did not provide any direct mechanism to encourage charitable donations through enhanced tax-measures. The charitable sector had been hoping for tax incentives, such as enhanced tax credits, but ended up with only a few sector specific government grants and contributions. Specifically, the Budget provided a targeted, two-year fund of $60 million to support infrastructure-related costs for local and community cultural and heritage institutions. This support is to be provided through Canadian Heritage programming.

One stimulus in the Budget that may indirectly have the effect of encouraging charitable donations was the Mineral Exploration Tax credit, which has been extended for another year until March 31, 2010. This credit is part of the incentives that encourage gifts of flow-through

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[11] For more information, see Terrance S. Carter and Karen J. Cooper, "Federal Budget 2009: Grants, Contributions and Earmarks, but no New Tax Incentives" in *Charity Law Bulletin* No. 156 (January 30, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb156.pdf.

[12] The excess business holding rules were introduced in the 2007 Federal Budget, which extended the elimination of the capital gains tax on gifts of publicly listed securities to private foundations. The excess business holding rules are intended to prevent abuse by persons connected with a private foundation who might, by virtue of their and the foundation's combined shareholdings, be able to exercise undue influence for their own benefit.

shares (tax-based financing incentives available to the oil and gas and mining sectors). The current rules effectively permit corporations to renounce or "flow-through" income tax deductions associated with certain activities to shareholders in exchange for the sale of their shares. The impact of the elimination of the tax on capital gains accruing on donations of publicly-traded securities to registered charities in previous budgets, when coupled with tax incentives on flow-through shares issued by companies in the resource sector, has generally attracted interest and planning opportunities for investors in the charitable sector.

It is hoped that the 2010 Federal Budget that is currently in the planning process will include some type of tax incentives, such as a "stretch" charitable tax credit that has been proposed by Imagine Canada, in order to encourage charitable giving.[13]

2. Possible Disbursement Quota Reform[14]

In an attempt to motivate discussions concerning an alternative regime to the confusion surrounding the current disbursement quota calculation ("DQ"), the National Charity and Not-For-Profit Law Section of the Canadian Bar Association ("CBA Charity Section") submitted a concept paper ("CBA Concept Paper") to the Department of Finance ("Finance") on July 20, 2009, as part of a submission to Finance regarding the upcoming 2010 Federal Budget. The CBA Concept Paper identifies the government's policy objectives concerning expenditures by charities and recommends alternative mechanisms to the DQ. The CBA Charity Section, having worked closely with other groups in the charitable sector, has long raised the concern that the DQ requirements are overly complex and arbitrary, creating difficulties, especially for smaller charities that depend mainly on donor funds as opposed to grants from the government.

Examples of the problems that the CBA Concept Paper identifies include difficult terminologies under the regime, like "enduring property" and "capital gains pool", which do not have clear

[13] The "stretch" tax credit is an innovative new credit proposed by Imagine Canada in their August 18, 2009 pre-budget brief to the House of Commons Standing Committee on Finance. The credit would give a "stretch" tax credit of 39% for donations over $200 that exceed a donor's previous highest giving level, starting with 2008 as a baseline. To continue to benefit from the credit, the donor in subsequent years would need to increase their level of giving over that 2008 baseline to a maximum of $10,000. For more information, see Imagine Canada, "For Canadians and their Communities: Securing a Better Future" (August 14, 2009) online: http://www.imaginecanada.ca/files/www/en/publicaffairs/2010_prebudget_submission_08082009.pdf.

[14] For more information, see National Charities and Not-For-Profit Law Section, Canadian Bar Association, "Concept Paper on Reform of the Disbursement Quota Regime", (July 2009), online: http://www.cba.org/CBA/submissions/pdf/09-40-eng.pdf.

applications or definitions. While the regulatory objectives of ensuring that current gifts are disbursed and that charities do not accumulate income or defer capital gains forever are important, the arbitrary 80% and 3.5% disbursement quotas are not efficient means of ensuring that the maximum amount of resources go towards the charitable purposes and activities of charities. The CBA Concept Paper suggests that the reform of the DQ regime should attempt to better pursue these policy objectives, respect donor restrictions on gifts, allow more flexibility in the timing of expenditures and investment strategies for charities and aim at regulatory simplicity with regard to compliance.

Given the recent release of the CRA's Guidance on Fundraising in June 2009 (discussed below), which addresses many of the concerns associated with inappropriate charitable expenditures, as well as the burdensome requirements of the 80% DQ regime, the CBA Concept Paper suggests either the simplification of the current formula by the repeal of the 80% component of the DQ formula, or the replacement of both the 80% and 3.5% components of the DQ formula with a penalty tax on "undue accumulations." It is hoped that the CBA Concept Paper will generate substantive discussion concerning the DQ regime and will eventually lead to an innovative alternative to better facilitate charitable donations and expenditure strategies by charities.

D. NEW GUIDANCES, COMMENTARIES AND OTHER PUBLICATIONS FROM CANADA REVENUE AGENCY

The following is a brief overview of some of the more important CRA Guidances, Commentaries and other publications from CRA published over the last 12 months, arranged in chronological order.

1. 3.5% Disbursement Quota Extended to All Charitable Organizations[15]

On November 28, 2008, CRA published a reminder to the charitable sector that for the fiscal period beginning on or after January 1, 2009, the 3.5% disbursement quota is to apply to charitable organizations registered before March 23, 2004. Charitable foundations (both public and private), as well as charitable organizations registered after March 22, 2004, were already subject to the 3.5% disbursement quota.

[15] For more information, see Terrance S. Carter, "CRA Releases Publication Outlining Important Changes for Registered Charities" in *Charity Law Bulletin* No. 154 (January 24, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb154.pdf.

The detailed method for the calculation of the 3.5% disbursement quota is set out in Regulations 3700, 3701, and 3702 of the *Income Tax Regulations*.[16] The calculation of the 3.5% disbursement quota is based on the average value of property owned by the charity, which was not used directly in charitable activities or administration, in the 24 months before the beginning of the fiscal period in question. For charitable organizations registered before March 23, 2004, they must know that value for 2007 and 2008 when calculating the 3.5% disbursement quota for the fiscal year 2009. The average value is recorded on a charity's annual information return, Form T3010B, on line 5900. However, if the average value of the charity's property not used for charitable activities or administration is $25,000 or less, the charity does not have to calculate the 3.5% disbursement quota.

2. New T2050 Application Form for Charitable Status[17]

In December 2008, CRA released a revised Form T2050, application for charitable status. A revised guide T4063 on how to complete Form T2050 was also released at the same time. Revisions to Guide T4063 ("the Guide") put "need to know" information about the advantages, requirements, and obligations of registered charities front and centre, all in order to facilitate the process of applying for charitable registration under the ITA.

In this regard, the Guide provides much more detailed information and explanations on the registration process and requirements, which is an improvement from the previous version of the Guide. The revised Form T2050 is similar to the previous version of the Form in many respects, except that it requires more detailed information to be provided in order to allow CRA to make a determination in light of the various policies that were put in place since the release of the last version of the Form T2050 in 2001. These include:

- more detailed questions on fundraising activities and associated costs, such as whether the organization intends to receive non-cash gifts or participate in a tax-shelter arrangement (in light of CRA's new Fundraising Guidance that was published after the release of the new Form T2050);

[16] For more information, see Theresa L.M. Man, "Calculation Of 3.5% Disbursement Quota For All Registered Charities" in *Charity Law Bulletin* No. 150 (December 18, 2008) online: <http://www.carters.ca/pub/bulletin/charity/2008/chylb150.pdf>.

[17] Excerpted from Theresa L.M. Man, "New Form T2050 Application for Charitable Status" in *Charity Law Update* (February 2009) online: http://www.carters.ca/pub/update/charity/09/feb09.pdf.

- questions on anticipated source of revenue from major donors (in relation to the new "control test" replacing the "contribution test" in the definition for charitable organizations and public foundations);
- more detailed questions on activities outside of Canada, including intended recipients of funds from the Canadian charity (in light of CRA's policy on charities operating outside of Canada released in 2002, and a new draft Guidance on foreign activities that was published after the release of the new Form T2050);
- questions on revenue from sources outside of Canada (in light of compliance requirements imposed on charities by anti-terrorism legislation);
- questions on ownership of more than 2% of a class of shares of a corporation (in light of the new corporate holdings rules imposed on private foundations);
- questions on anticipated revenue from the sale of goods, services and use of assets; and how each such activity relates to the organization's purposes (in light of the policy on related business released in 2003); and
- clarification on what personal information on the directors is considered public information (i.e. name and position in the organization), as opposed to confidential information (i.e. address, phone number and date of birth).

When completing Form T2050, the applicants will need to carefully review the explanation in the Guide and provide sufficient information to CRA in order to avoid unnecessary delay in the processing of the application.

3. Introduction of New T3010B Annual Information Return[18]

On February 20, 2009, the CRA released online the new form T3010B, which is the new annual information return for registered charities that is to be used for fiscal periods ending on or after January 1, 2009. Accompanying the new T3010B form are three slightly-revised attachments: T1235(09) – *Directors/Trustees and Like Officials Worksheet*; T1236(09) – *Qualified Donees Worksheet / Amounts Provided to Other Organizations*; and T1259(09) – *Capital Gains and Disbursement Quota Worksheet*. The CRA has also released T4033B – *Completing the*

[18] For more information, see Terrance S. Carter, "Commentary on the New T3010B Annual Information Return" in *Charity Law Bulletin* No, 158 (February 26, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb158.htm.

Registered Charity Information Return, which will assist charities in filling out and filing the new information return.

The T3010B form is CRA's response to many requests from registered charities to simplify the information return and reduce the filing burden for small charities that may have limited resources for addressing administrative requirements. While the new form is anticipated to generally benefit smaller charities, the form is also designed to require additional information from other charities. In this regard, larger charities with broad operations will likely be filling in more information than they did in the previous form.

a) Overall Structure of the Forms

The nine sections found in the old T3010A have been converted into six sections, along with six schedules. On a practical level, this means that the new form actually consists of two parts. Sections A to F comprise the primary portion that must always be completed, while Schedules 1 to 6 relate to particular matters and only need to be completed if triggered by specific answers provided in the primary portion. Similarly, Form T1236(09) – *Qualified Donees Worksheet / Amounts Provided to Other Organizations* functions in the same way as these schedules, in that it is completed and attached only if triggered by a specific answer in the primary portion. However, Form T1235(09) – *Directors/Trustees and Like Officials Worksheet* or a sheet with equivalent information must be attached.

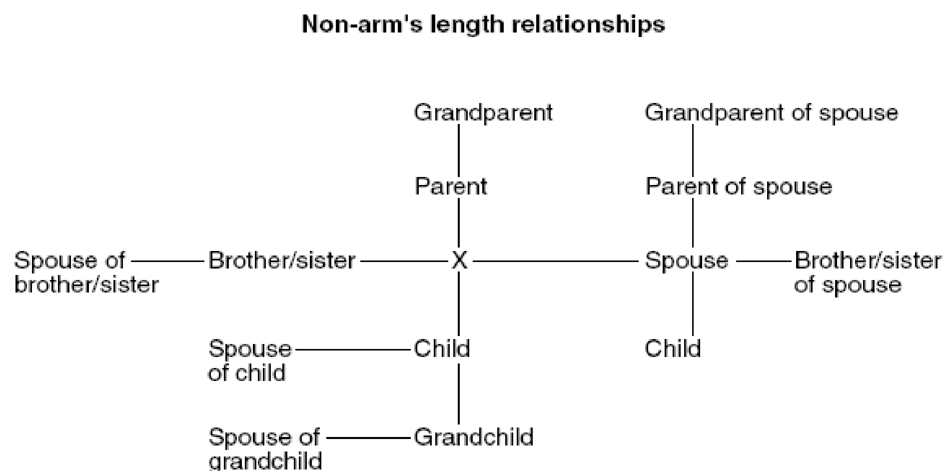
b) Directors/Trustees and Like Officials

Section B – Directors/Trustees and Like Officials remains essentially the same in the new form, but now expressly states that the CRA may share confidential information as permitted by law, such as sharing with certain other government departments and agencies. This is in accordance with Bill C-25, which amended the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.[19] Bill C-25 permits the CRA to share information about directors and officers with the

[19] *An Act to amend the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the Income Tax Act and to make a consequential amendment to another Act* ["Bill C-25"], which received Royal Assent on December 14, 2006.

Canadian Security Intelligence Service ("CSIS"), the Royal Canadian Mounted Police ("RCMP"), as well as foreign governments and agencies.[20] This new fact should be of concern to directors and officers of all charities, but particularly to charities that carry on activities outside of Canada.

Form T1235(09) – *Directors/Trustees and Like Officials Worksheet* or a sheet with equivalent information, which is a mandatory attachment, has been revised and is more informative and user-friendly. The form is now presented in a "landscape" layout, which provides more space to input data. Additional information on filling out the worksheet is now included in the T1235(09), such as an explanation and diagram of which related persons would be considered "non-arm's length." This diagram is reproduced below for ease of reference:



c) Programs and General Information

Section C – Programs and General Information has been totally reworked and includes a number of questions that will trigger the requirement to complete a schedule or worksheet attachment. For example, additional information is

[20] For more information, see Terrance S. Carter & Sean S. Carter, "New Anti-terrorist Financing Law Has Direct Impact for Charities", *Anti-Terrorism and Charity Law Alert* No. 12 (January 24, 2007), online: <http://www.carters.ca/pub/alert/ATCLA/ATCLA12.pdf>. For detailed commentary on the effects of Canadian anti-terrorism legislation on charities, see Terrance S. Carter, "The Impact of Anti-terrorism Legislation on Charities in Canada: The Need for Balance" (Paper presented at the University of Iowa Provost's Forum on International Affairs 2008: Counter-Terrorism and Civil Society, April 2008), online: http://www.carters.ca/pub/article/charity/2008/tsc0419.pdf.

required for charities that operate outside of Canada (Schedule 2), pay external fundraisers (Schedule 4 – which is confidential), pay compensation to employees (Schedule 3), or receive non-cash gifts (Schedule 5). The new form specifies clearly that charities must complete and attach T1236(09) – *Qualified Donees Worksheet / Amounts Provided to Other Organizations* if they have given gifts or transferred funds to qualified donees or other organizations.

Charities that carry on activities outside Canada will now need to complete Schedule 2 – Activities Outside Canada. In this regard, Schedule 2 requires that the charity will need to indicate the name of the individuals or organizations that have received resources of the charity under an arrangement with the charity (such as a contract for services, an agency agreement, or joint venture agreement), the country where the activities were carried out and the dollar amount of the resources that were expended. This information about individuals or organizations carrying on activities outside of Canada is not confidential, and therefore might put those individuals or organizations at risk in some situations. As such, it may now be necessary in certain high-risk situations to disclose to recipient individuals or organizations carrying on activities outside of Canada that their identity will be disclosed in the public portion of the annual return of the charity.

As well, in order to address other provisions concerning donors under the ITA, as amended by Bill C-25, an important addition to the new form now includes a question to determine if the charity received a donation valued at $10,000 or more from a donor who was not a resident in Canada and was not any of the following:

- a Canadian citizen;
- employed in Canada;
- carrying on business in Canada; or
- a person having disposed of taxable Canadian property.

If a donation was received in this regard, then the charity must provide information in Schedule 4 (which the CRA classifies as confidential data) concerning the donor as well as the amount donated. Charities will need to ensure

that they have the requisite information from non-resident donors to satisfy the reporting requirements in Schedule 4. Obtaining this information from donors though, may be easier said than done, given the fact that in accordance with Bill C-25, the information can be shared with CSIS, the RCMP, as well as foreign governments and agencies.

d) Financial Information

Perhaps the most substantial difference between the old T3010A and the new T3010B form is Section D, which is a simplified and shorter section regarding the charity's financial information. In accordance with the CRA *Report on Small and Rural Charities*, one of the CRA's goals for the new T3010B was to reduce the filing burden for smaller charities. In order to benefit from these reduced filing requirements for financial information, the charity cannot have any of the following apply to it:

- The charity's revenue exceeds $100,000.
- The amount of all assets (e.g., investments, rental properties) not used in charitable programs exceeds $25,000.
- The charity has permission from CRA to accumulate funds during this fiscal period.
- The charity has spent or transferred enduring property during this fiscal period.

Permission to accumulate funds typically occurs when a charity wants to save funds for a major purchase, such as a building. Because it may be difficult for the charity to save these funds, as well as to meet its disbursement quota for charitable programs, the charity may apply to CRA for permission to accumulate funds.

Charities that do not satisfy all the criteria listed above must instead complete Schedule 6, which is a much lengthier and more detailed financial information section, similar to that of the old T3010A form.

e) Summary Comments

With the exception of the question pertaining to donors of gifts over $10,000 who are not residents in Canada and the requirement to name third party recipients of funds received outside Canada in accordance with the requirements of Bill C-25, the substance of the questions in the new T3010B form is not radically different from that of the old T3010A form. However, the reorganization and rewording of the form is more streamlined and therefore more user friendly for charities. Most importantly, the simplified financial information sections will be a welcome development for eligible smaller charities.

4. CRA Introduces Anti-Terrorism Checklist[21]

On March 29, 2009, CRA released its long-awaited Checklist for Charities on Avoiding Terrorist Abuse (the "Checklist"),[22] a checklist that is intended to help Canadian charities identify vulnerabilities to terrorist abuse and develop good management practices. CRA indicates that the Checklist is based on international and domestic concerns, experience, and guidance, and is not meant to be a comprehensive guide. Rather, it is intended to help Canadian registered charities focus on areas that might expose them to the risk of being abused by terrorists or other criminals.

While the introduction of the Checklist is certainly a step in the right direction in recognizing the need to provide guidance to the Canadian charitable sector, a review of the Checklist suggests that CRA may not have gone far enough in providing the necessary practical guidance to which the House of Commons Subcommittee was referring.

In this regard, the Checklist consists only of the following questions:

- "Do you know about the individuals and entities associated with terrorism, which are listed in Canada under the United Nations Act and the *Criminal Code*? Are you aware of the *Criminal Code* and the *Charities Registration (Security Information) Act* provisions

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[21] For more information see Terrence S. Carter and Nancy E. Claridge, "CRA's New Anti-Terrorism Checklist – A Step in the Right Direction" in *Anti-Terrorism and Charity Law Alert* No. 17 (April 29, 2009) online: http://www.carters.ca/pub/alert/ATCLA/ATCLA17.pdf.
[22] Available at http://www.cra-arc.gc.ca/tx/chrts/chcklsts/vtb-eng.html.

on financing and supporting terrorism — and the consequences of breaching the provisions?

- Do you have a good understanding of the background and affiliations of your board members, employees, fundraisers, and volunteers?

- Have you read the CRA guidance about keeping adequate books and records, activities, engaging in allowable activities, operating outside Canada, and charities in the international context? Do you follow this guidance?

- Do you have appropriate, sound, internal financial and other oversight and verification controls — for example, appropriate delegations and separations of authority over the collection, handling, and depositing of cash and the issuing of receipts?

- Do you transfer money using normal banking mechanisms, wherever possible? When it is not, do you use reputable alternative systems, and have strong additional controls and audit trails to protect your charity's funds and show how and when they were used?

- Do you know who uses your facilities and for what purpose — for example, your office or meeting space, name, bank account, credit cards, Web site, computer system, telephone or fax — what they are saying, and what materials they are distributing or leaving behind?

- Do you try to find out who else might be supporting a person or cause that you are endorsing in public statements, and who uses your name as a supporter?

- Do you know where your donations and other support really come from?

- Do you know who has ultimate control over the project that your charity's money and resources are benefiting, and what the money and resources are used for, including after the particular project is finished?

- Do you know your partners in delivering the work you are doing, and their affiliations to other organizations?

- Do you have clear written agreements with agents/contractors/other partners, in Canada and abroad, covering what activities will be undertaken and how they will be monitored and accounted for? Do you check that the agreements are being followed?"

The Checklist then ends off by providing a number of links to helpful websites and international guidelines for more information, such as the Charity Commission for England and Wales' *Themes and lessons from the Charity Commission's compliance work, 2007–08 Operational Guidance – Charities and Terrorism*, and the U.S. Department of the Treasury's *Anti-Terrorist Financing Guidelines – Voluntary Best Practices for U.S.-Based Charities*.

Notwithstanding the positive step that CRA has taken in introducing its anti-terrorism checklist, the Checklist does raise a number of concerns, most of which relate to the overall usefulness of the document. These issues are briefly discussed below as follows:.

a) Not Sufficient Context for Charities

While brevity is normally considered to be a virtue, in the context of providing registered charities with guidance with respect to anti-terrorism provisions in Canada and abroad, brevity can also be a dangerous thing under certain circumstances. Charities and those who participate in charitable programs need to have a clear understanding of the possible penalties that exist for failure to comply with anti-terrorism legislation. In particular, charities should understand the broad scope of the *Criminal Code* (Canada) provisions pertaining to terrorist activity and, in particular, the facilitation provisions thereof. A brief checklist with only passing references to external guidelines arguably does not provide sufficient information for charities to be properly informed and to adequately conduct the necessary due diligence investigations required for necessary compliance purposes.

b) Potential Undue Sense of Simplicity

The use of a short checklist with some additional commentary with links to outside documents published by both CRA and other international bodies may create the impression of an undue sense of simplicity in relation to a charity's compliance with Canada's anti-terrorism legislation. As there are significant consequences for both the charity and the individual directors and officers if they are found to have unwittingly assisted a terrorist organization or terrorist activity (or even if there is an allegation of such support), it is potentially misleading to suggest that compliance is as simple as what is set out in a brief checklist.

c) Continued Delegation

Over the last eight years, there have been repeated calls from both government and the charitable sector for "made in Canada" guidance with respect to compliance with anti-terrorism guidelines. In this regard, the Checklist appears to have missed the opportunity to provide meaningful guidance to Canadian charities and instead continues to indirectly delegate this function to foreign governments and quasi-governmental bodies. For Canadian charities to not have a "one-stop shop" for anti-terrorism compliance means that they will continue to be forced to refer to multiple documents and differing standards of compliance, which will likely result in continued confusion for Canadian charities. For example, is compliance with the Checklist sufficient? or should there also be compliance with the U.S. Guidelines and Charities Commission of England and Wales' guidelines that are listed in the Checklist?

Continued delegation does not recognize that "made in Canada" due diligence guidelines are necessary in recognition of Canada's unique position given its broad anti-terrorism legislation and its significant international commitments that have driven its legislation. In other words, compliance with the U.S. Guidelines, or those of the Financial Action Task Force on money laundering or the Charities Commission of England and Wales does not necessarily ensure compliance with Canadian anti-terrorism legislation, i.e. those unique aspects of Canada's anti-terrorism legislation that are not replicated elsewhere.

d) Excessive Recommendations

Several of the recommendations in the CRA Checklist are potentially excessive and may therefore be difficult for charitable organizations to comply with.

First, there is the recommendation that the charitable organization should not only know the individuals or organizations that are using its facilities, but the charity should also know the subjects they are discussing and the materials they are distributing/leaving behind. A fundamental principle of all due diligence guidelines concerning anti-terrorism is that the charity should know who they are dealing with. However, it appears to be excessively burdensome to require a charity to know what subjects are being discussed and all the materials that are being distributed, etc. by people using the office, meeting space or telephone or fax of a charity.

Second, there is the recommendation that the charity take reasonable steps to determine "who else might be supporting any person or cause you are endorsing in any public statements". As there are possibly thousands of individuals and groups that may support a cause, it seems to be an excessive burden to place on a charity to determine who else supports the same cause without any corresponding benefit in relation to anti-terrorism due diligence.

Third, there is the recommendation that the charity have a "good understanding of the background and affiliations" of its board members, employees, fundraisers and volunteers. In many situations, such an obligation would require a charity to keep extensive dossiers on literally thousands of individuals, with little corresponding benefit and possibly significant detriment to the effective functioning of the organization. For example, what benefit is obtained in relation to compliance with anti-terrorism legislation by a charity having a "good understanding of the background and affiliations" of a volunteer who serves meals or cleans dishes in a soup kitchen, and how many individuals are going to volunteer their time and talent if they are subjected to such types of scrutiny?

e) Summary Comments

Although due diligence is not a defence for violations of the anti-terrorism laws in Canada and abroad, or against revocation of charitable status under the ITA, effective due diligence is, at the very least, necessary in order to show a desire to comply. Apart from compliance with anti-terrorism laws, maintaining due diligence is also mandatory in accordance with the common law fiduciary duties of directors to protect charitable property.

Canadian charities deserve comprehensive guidelines and guidance from CRA that does not force the charity to reconcile multiple international standards in order to comply with Canadian anti-terrorism legislation in a vacuum. In this regard, while CRA is to be applauded for trying to develop a "made in Canada" set of due diligence guidelines, the Checklist does not fully meet this goal and may instead be the cause of further confusion for Canadian charities in this difficult area of the law.

5. CRA Releases Policy Commentary on Requests for Disbursement Quota Relief[23]

On April 6, 2009, CRA released a policy commentary (CPC-029) regarding requests for disbursement quota relief. CRA describes the disbursement quota as the "the minimum amount that a registered charity must spend each year on charitable activities carried on by it or on gifts to qualified donees." Subsection 149.1(5) of the ITA states that a charity may apply for relief from its disbursement quota requirements. If granted, the relief would be applicable to the particular tax year only.[24]

The following is a summary of relevant considerations mentioned in the policy commentary applicable to applying for relief from disbursement quota requirements under s. 149.1(5) of the ITA.

- A charity may apply a disbursement excess from one year to offset shortfalls in its disbursement. The excess may be applied in the year before the year of the shortfall and

[23] Excerpted from Terrance S. Carter, "CRA Policy Commentary on Requests for Disbursement Quota Relief" in *Charity Law Update* (April 2009) online: http://www.carters.ca/pub/update/charity/09/apr09.pdf.
[24] For a discussion on how disbursement quota relief may be useful in managing a charity's endowment funds, see Terrance S. Carter, "Managing Endowments During Difficult Financial Times" in *Charity Law Bulletin* No. 161 (March 26, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb161.htm.

in the five years immediately following. The charity must use all disbursement excesses from previous years before relief will be granted.

- The charity must demonstrate that it is incapable of making up any part of the disbursement shortfall in the following tax year. Therefore, all of the charity's information returns must be filed before any requests are considered, and relief will not be granted in advance or anticipation of a shortfall.
- The charity must be unable to meet the disbursement quota due to unforeseen circumstances that are beyond the charity's control.

To apply for relief, a charity must complete Form T2094, *Registered Charities: Application to Reduce Disbursement Quota*. In deciding whether or not to grant relief, CRA will check that the charity: is not in a shortfall situation simply because of a miscalculation of its disbursement quota; has no available excesses; has disbursed all available income; and is doing everything in its power to meet its disbursement quota, such as drawing upon unrestricted funds to meet the quota.[25]

6. CRA Releases a Policy and Guidance on Sports and Charitable Registration [26]

On April 30, 2009, the CRA released a revised Summary Policy on Sport (CSP-S14), which outlines the requirements for charities engaged in sports to be eligible for charitable status, emphasizing that the promotion of sports is not recognized as being inherently charitable, and therefore such organizations must demonstrate how sports carries out their charitable purposes.

CRA also released its final form of Guidance on Sports and Charitable Registration (CPS-027) (the "Guidance") on April 30, 2009, which provides further discussion on how those requirements might be achieved. However, the Guidance does not apply to Canadian amateur athletic associations.

The Guidance will be of particular interest to religious charities that conduct sports activities, because it specifically states that it must be clear that the sport element of a charity's activities is not a "collateral non-charitable purpose". However, the Guidance does not provide any further elaboration on how a sports activity might become a collateral non-charitable purpose of a

[25] For more details, see: http://www.cra-arc.gc.ca/tx/chrts/plcy/cpc/cpc-029-eng.html.
[26] Excerpted from Terrance S. Carter, "New CRA Summary Policy and Guidance on Sports" in *Charity Law Update*, (May 2009) online: http://www.carters.ca/pub/update/charity/09/may09.pdf.

religious charity instead of simply being a means to achieve advancement of religion. In this regard, the Guidance refers to the forthcoming CRA Guidance on Advancement of Religion for clarity in this regard. [27]

7. CRA Proposed Guidance on the Protection of Human Rights and Charitable Registration[28]

On May 8, 2009, CRA released a draft policy document entitled *Consultation on proposed Guidance on the Protection of Human Rights and Charitable Registration* (the "Draft Guidance").[29] The purpose of the Draft Guidance is to provide guidelines for determining whether or not an organization that is established to protect human rights can be registered as a charity under the ITA. As such, the Draft Guidance will be highly relevant to human rights organizations that are considering charitable registration, as well as existing charities that engage in the protection of human rights.

In general terms, organizations that are seeking to become registered charities must have purposes that are considered, at law, to be charitable and for the benefit of the public. At common law, it has been established that there are four categories under which a charitable purpose must fall: the relief of poverty, advancement of education, advancement of religion, and other purposes beneficial to the community not falling under the first three categories.[30]

The Draft Guidance states that Canadian jurisprudence has indicated that the protection of human rights can be a charitable purpose, such as the case of *Action by Christians for the Abolition of Torture (ACAT) v. The Queen*,[31] in which the court stated that an organization with the purpose of abolishing torture is, on its face, a charity.

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[27] These documents are available through the following links:
Summary Policy: http://www.cra-arc.gc.ca/tx/chrts/plcy/csp/csp-s14-eng.html
Guidance: http://www.cra-arc.gc.ca/tx/chrts/plcy/cps/cps-027-eng.html

[28] For more information see Terrance S. Carter, "CRA Draft Guidance on the Protection of Human Rights and Charitable Registration" in *Charity Bulletin* No. 166 (May 28, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb166.pdf.

[29] Canada Revenue Agency, *Consultation on Proposed Guidance on the Protection of Human Rights and Charitable Registration* (May 6, 2009), online: http://www.cra-arc.gc.ca/tx/chrts/plcy/cnslttns/ghrg-eng.html

[30] *Special Commissioners of Income Tax v. Pemsel*, [1891] A.C. 531 (H.L.).

[31] 2002 FCA 499.

The Draft Guidance establishes a clear definition of what constitutes "human rights", which are those individual rights and freedoms acknowledged, within their prescribed limitations, in the listed legal instruments:

The "protection of human rights" is defined in the Draft Guidance as "activities that seek to encourage, support, and uphold human rights that have been secured by law, internationally or domestically." It is expressly stated that the protection of human rights does not include advocacy for new legal rights at any level, both nationally and internationally.

When applying for registration, the Draft Guidance explains that human rights organizations should set out its charitable purposes and activities by specifying (1) the source or concept of human rights that will be applied to their activities; (2) the specific location, country, or range of countries in which each activity will be carried out; and (3) a detailed description of all the present and proposed activities they plan to undertake to fulfill their purposes.

CRA recognizes that the breadth of human rights issues means that a charity's focus on particular issues, geographic regions or vulnerable groups should be acceptable as long as the restriction of the public benefit is justifiable.

a) Human Rights and the Four Heads of Charity

The Draft Guidance provides specific examples of how the protection of human rights could further each of the four heads of charity. Although each head of charity is addressed separately, it is certainly possible that a charity's purposes could involve more than one category.

i) Relief of Poverty

This category generally involves the provision of the necessities of life, such as food, clothing and shelter, or amenities that are generally taken for granted. According to the Draft Guidance, the relief of poverty also includes the relieving of human suffering and distress, as established in *McGovern and others v. Attorney General*.[32] In this regard, human rights

[32] [1981] 3 All E.R. 493 at 503.

charities can engage in the relief of poverty by providing for the needs of people whose human rights have been infringed upon.

ii) Advancement of Education

According to established case law referenced in the Draft Guidance, the advancement of education, as a charitable purpose, means training the mind; advancing the knowledge or abilities of the recipient; raising the artistic taste of the community; or improving a useful branch of human knowledge through research. The basic purpose under this head of charity is to increase human knowledge, which must be achieved through a structured attempt at education, a clear teaching or learning component that is available to students and the general public, and must not be intended to promote a particular point of view.

iii) Advancement of Religion

The advancement of religion as a charitable purpose involves promoting and manifesting the doctrines, observances, and practices of a religion. Human rights charities may advance religion by clearly establishing the connection between the doctrines of the religion that support human rights, and the purposes/activities of the charity.

iv) Other Purposes Beneficial to the Community

The fourth head of charity provides for charitable purposes that do not fall under the first three heads, and there are many ways in which human rights organizations may be charitable in this regard. The Draft Guidance identifies that human rights organizations may often have purposes that are already recognized under the fourth head, including: (1) mental and moral development of the community, such as promoting awareness of the protection of human rights; (2) upholding the administration and enforcement of human rights law, such as monitoring and reporting on the fulfillment of human rights obligations by various treaty signatories; and

(3) preserving human life and health, such as protecting victims of human rights abuses.

b) The Importance of Understanding Political Purposes and Activities

i) Political Purposes

Under the ITA and at common law, organizations cannot be charitable if they are established for a political purpose. As such, the Draft Guidance emphasizes the fact that charities engaged in protecting human rights will often need to work outside of existing political and legal structures, and therefore must ensure that the charitable purposes are not political as well.

Therefore, human rights charities will have political purposes if they undertake purposes such as lobbying governments to amend human rights law or to sign a particular treaty. On the other hand, the purpose will not be political if the charity is simply investigating and reporting human rights violations of existing legislative instruments.

The Draft Guidance provides further guidelines for charities that seek to operate internationally, cautioning that the concept of "political purposes" is not universal. For example, the death penalty is not uniformly accepted or rejected as a human rights abuse in every country, and therefore, advocacy against the death penalty may be political in nature in some countries and non-political in others.

ii) Political Activities

While political purposes are always impermissible, CRA recognizes that human rights charities may engage in some non-partisan political activities that support that charity's purposes. A charity may do so only under two conditions. Firstly, the charity must devote substantially all of its resources to its charitable activities. This means that no more than 10% of a charity's resources can be used for political activities (this is extended to 20% for

smaller charities). Secondly, the political activities must be connected and subordinate to the charity's purposes.

These parameters indicate that a human rights charity can actually engage in activities, such as pressuring governments towards legislative change, if the activity falls within the said acceptable limits. For example, an allowable political activity could involve placing an advertisement in a newspaper to pressure the government on a particular human rights law, provided that this is connected and subordinate to the charity's primary activities. On the other hand, publishing advertisements that praise or denounce a certain politician or political party regarding their position on human rights would be unacceptable.

8. CRA's New Guidance on Fundraising[33]

On June 11, 2009, the Charities Directorate of the CRA released its much anticipated Guidance (CPS-028): Fundraising by Registered Charities (the "Fundraising Guidance"). The Fundraising Guidance, which includes an additional 23 page document to elaborate on the Guidance (the "Additional Information"), replaces CRA's previous policy on fundraising (CPS-001), entitled "Applicants that are Established to Hold Periodic Fundraisers."

CRA previously released draft versions of the Fundraising Guidance and Additional Information entitled "Consultation on Proposed Policy on Fundraising by Registered Charities" and "Background information for Proposed Policy on Fundraising by Registered Charities" in March and June of 2008, respectively, (collectively the "Proposed Policy"). As such, the Fundraising Guidance has been in refinement for over a year. Given the importance of fundraising to the charitable sector, its release has been closely followed by most stakeholders. However, while the Fundraising Guidance represents an improvement over the Proposed Policy, it will likely prove challenging for most charities to comply with and, as such, it will be important for practitioners to be familiar with the terms of the Fundraising Guidance.

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[33] For a more detailed commentary on the Guidance, see Terrance S. Carter, "The Revised CRA Guidance On Fundraising: Improved But Still Challenging" in *Charity Law Bulletin* 169 (June 25, 2009), online: http://www.carters.ca/pub/bulletin/charity/2009/chylb169.htm.

a) Fundraising in the Charitable Context

At the outset, the Fundraising Guidance explains that if a fundraising activity is appended to another activity that is directed at achieving a charitable purpose, the charity may, under certain specified situations, allocate the costs between fundraising and charitable expenditures. The Fundraising Guidance goes on to explain, however, that in addition to complying with the terms of the Fundraising Guidance, charities must also meet all other requirements of the ITA, such as its annual disbursement quota. While this fact is not a change in CRA's position, it had not been expressly stated in the Proposed Policy, which might otherwise have led to confusion between the need to comply with statutory disbursement quota requirements and fundraising expenditure requirements in the Proposed Policy.

b) Definition of Fundraising and Other Terms

The Fundraising Guidance explains that as a general rule, fundraising constitutes any activity related to a solicitation of support; either carried out by the charity or by another party acting on the charity's behalf, but does not include requests for funding from governments or from other registered charities. This means that not only are the costs associated with such requests not included in the fundraising expenses, but the resulting income from government and other charities is also not included in the income with regards to the fundraising ratio explained below.

c) Prohibited Fundraising Conduct

The Fundraising Guidance outlines four types of prohibited conduct related to fundraising, these being fundraising that (a) is illegal or contrary to public policy; (b) is a main or independent purpose of the charity; (c) results in more than an incidental or proportionate private benefit to individuals or corporations; and (d) is misleading or deceptive.

d) Allocation of Fundraising Expenditures

A registered charity must report all fundraising expenditures in its T3010B annual information return. However, an activity does not have to be included as a fundraising expenditure if it can be demonstrated that "the activity would have

been undertaken whether or not it included a solicitation of support." There are two methods by which this can be demonstrated: (1) the "Substantially All Test," such that the charity does not have to report any of the costs of the activity as fundraising expenditures; or (2) the "Four Part Test," which allows the charity to allocate a portion of the costs as non-fundraising expenditures. However, charities will likely find some aspects of the "Four Part Test" to be unusually complex, as at least one of the four part tests involves multiple layers of questions.

e) Evaluation of Fundraising Activities

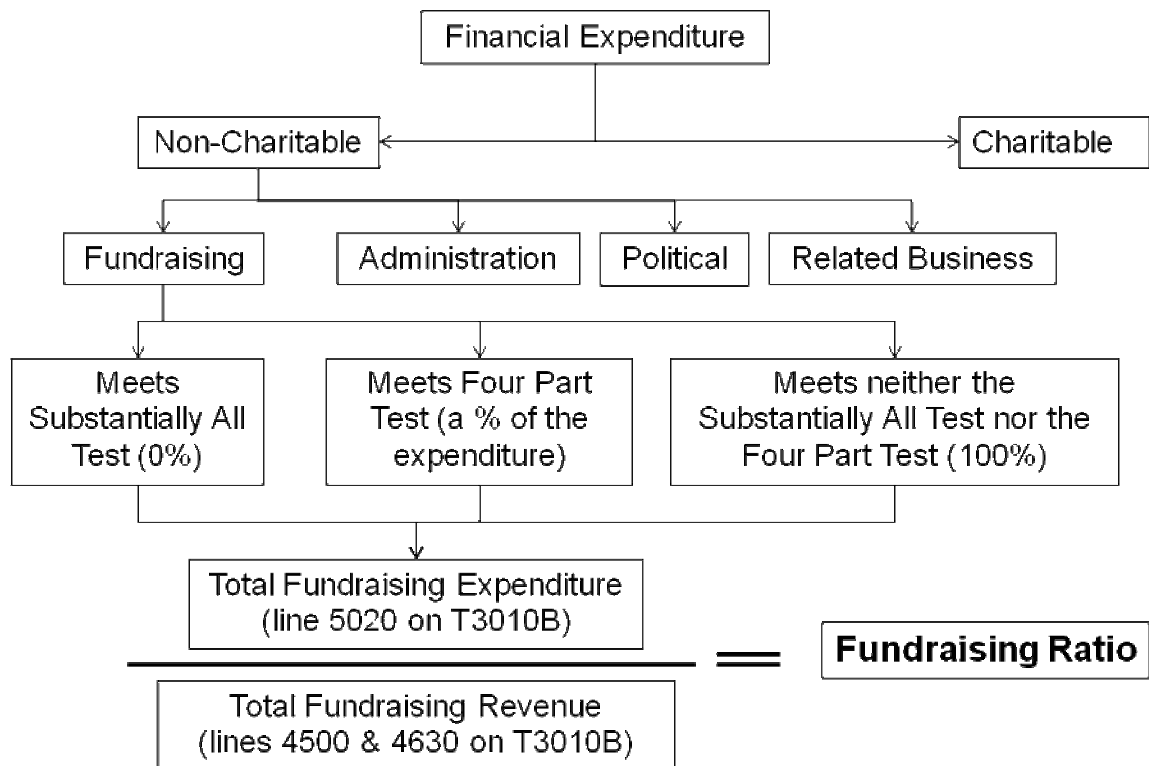
The previous rigidity and arbitrariness of using five fixed-percentage ranges as an initial determination tool was a major subject of criticism of the Proposed Policy, whereas the Fundraising Guidance establishes a far more flexible approach. In this regard, the Guidance introduces the following revised fundraising ratios.

- Under 35% - Unlikely to generate questions or concerns.

- 35% and above - CRA will examine the average ratio over recent years to determine if there is a trend of high fundraising costs. The higher the ratio, the more likely it is that a more detailed assessment of expenditures will be required.

- Above 70% - The charity will be required to provide an explanation and rationale for this level of expenditure to show that it is in compliance; otherwise, it will not be acceptable.

The chart below can be useful in determining the fundraising ratio, although it has not been prepared by CRA.



In addition, the Fundraising Guidance sets out a number of factors that are to be considered in the evaluation of fundraising activities, as well as a series of "best practices" and "areas of concern" indicators that can be considered by CRA. "Best practices" indicators that decrease the risk of CRA finding unacceptable fundraising include the following;

i) Prudent planning processes

- e.g. Where the charity researches anticipated costs and revenues

ii) Appropriate procurement processes

- e.g. Solicit bids from three or more potential suppliers or issuing RFP's

iii) Good staffing processes

- e.g. Setting compensation that is appropriate compared to other employees of the charity in light of respective responsibilities
- e.g. Should avoid performance evaluation based solely or excessively on performance or results. Ongoing management and supervision of fundraising practice

- e.g. Establish and implement a fundraising policy

iv) Adequate evaluation processes

- e.g. At a minimum regularly assess its fundraising performance compared to CRA Guidance

v) Use made of volunteer time and volunteered services or resources

- e.g. Demonstrates a commitment to minimize the expenditure allowable for the fundraising activity

vi) Disclosure of fundraising costs, revenues and practice (including cause-related or social marketing arrangements)

- e.g The information must be accessible and accurate

f) Areas of Continuing Concern

While the Fundraising Guidance constitutes a noticeable improvement over the Proposed Policy, charities and their legal advisors should be aware that many of the concerns about the Proposed Policy that were raised during the public consultation phase continue to be found within the Fundraising Guidance. Some of those concerns are outlined below.

i. While the language has been simplified and the length reduced, the substantive concepts from the Proposed Policy remain largely unchanged, such that the Fundraising Guidance still constitutes a complex document that could prove difficult for charities to fully understand and implement.

ii. The more flexible and open-ended approach to evaluating fundraising activity is certainly an improvement over the Proposed Policy. However, many of the factors and criteria in the Fundraising Guidance continue to be open to subjective interpretation. As such, there will likely be variations and inconsistencies in the interpretation of the Fundraising Guidance by charities and their professional advisors, as well as by CRA auditors.

iii. Although the "best practices" and "areas of concern" are not requirements that must be followed by charities, some of those recommendations may prove

challenging for charities to comply with. Specifically, the Fundraising Guidance emphasizes the importance of pubic disclosure and transparency regarding the cost of fundraising activities. While there is no disagreement that transparency in and disclosure of fundraising costs is important, the extent of the expectation placed on charities by the Fundraising Guidance may result in some charities having difficulty in attracting donors when it is necessary for the charity to disclose the estimated fundraising costs and revenues of its annual budget when asking for a donation from a prospective donor.

iv. Due to the time delays that often occur in fundraising campaigns from the time donations are requested to when donations are received, it would have been preferable if CRA had used a rolling average (e.g. over several years) as the basis for evaluation instead of on a single fiscal year basis.

g) Summary Comments

While the Fundraising Guidance is clearly a marked improvement over the Proposed Policy, it will likely prove to be a challenging document for charities and their lawyers and professional accountants to work with. As a result, it may take the charitable sector some time to fully comprehend its implications. Given that the Fundraising Guidance is only intended to constitute a clarification of CRA's position on fundraising, the Fundraising Guidance will apply to audits in both future and past years. As such, it is important that all registered charities which depend on fundraising, together with their staff, board members and professional advisors, become familiar with the content of the Fundraising Guidance. The ability of a charity to retain its charitable status in the future may very well depend on whether it can show that it has made reasonable efforts to meet the requirements of the Fundraising Guidance.

9. CRA's Proposed New Guidance for Charities Operating Outside Canada[34]

On June 30, 2009, CRA released a draft consultation paper entitled *Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities* ("Proposed Guidance"),[35] which is intended to update and replace the publication on foreign activities entitled *Registered Charities: Operating Outside Canada* RC4106 ("Current Policy").[36] The Proposed Guidance constitutes an improvement over the Current Policy by providing a more practical guide for charities that operate outside of Canada. Also, the Proposed Guidance is intended to apply to all activities carried on through intermediaries both outside and within Canada.

a) Use of Intermediaries

The Proposed Guidance explains that a registered charity can pursue its charitable purposes by either (1) making gifts to qualified donees; or (2) carrying out its own charitable activities. When a charity cannot carry out an activity with its own staff, a charity is permitted to use an intermediary. The Proposed Guidance explains the different types of intermediary relationships that are acceptable to CRA:

i) Agents

The Proposed Guidance states that a registered charity can carry on its own charitable activities through the use of agents. In the Current Policy, CRA explains that a charity must consider the risks associated with an agency and an implied agency relationship before embarking upon this type of arrangement. It is also noted that CRA recommends in the Current Policy that charities should carefully structure these arrangements to reduce possible liability associated with an agency relationship.

[34] Excerpted from Terrance S. Carter and Karen J. Cooper, "Operations outside Canada? New rules are in the works for you" in Canadian Fundraiser (August 31, 2009) online: http://www.canadianfundraiser.com/newsletter/article.asp?ArticleID=3078. For more information, see Terrance S. Carter, "CRA's Proposed New Guidance For Charities Operating Outside Of Canada" in *Charity Law Bulletin* No. 172 (July 30, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb172.pdf.

[35] Canada Revenue Agency, *Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charitie*s (May 6, 2009) online: http://www.cra-arc.gc.ca/tx/chrts/plcy/cnslttns/ccrc-eng.html.

[36] Canada Revenue Agency, *RC4106 Registered Charities: Operating Outside of Canada* (Oct 15, 2000) at 4, online: http://www.cra-arc.gc.ca/E/pub/tg/rc4106/README.html.

Unfortunately, this warning about the significant liability associated with utilizing an agent as an intermediary is absent in the Proposed Guidance. Instead, CRA simply warns charities that they "must always be able to show that the agent is carrying on the charity's own charitable work."

ii) Joint Venture Participants

The Proposed Guidance then explains that a charity can also carry on its activities jointly with other organizations or individuals. This can occur through joint ventures where the joint venture participants pool their resources in order to accomplish their goal in accordance with the terms of a joint venture agreement. As a joint venture participant, a charity can work with non-qualified donees as long as the charity is exercising control over the activities proportionate to the resources it is providing and it can demonstrate this fact.

iii) Co-operative Participants

The Proposed Guidance explains that charities can be considered co-operative participants in situations where the charity works side by side with another organization to achieve a particular goal, but the organizations do not pool their resources or carry out the project as a joint venture. In the Current Policy, CRA refers to co-operative participants as "co-operative partnerships." This terminology is not used in the Proposed Guidance, which is likely a good idea, since the relationship described is that of a co-operative undertaking as opposed to a legal partnership, which the common law defines as an activity carried out in common with a view to a profit. CRA defines a co-operative participant as "an organization that a charity collaborates with to achieve a common, charitable purpose. It is not meant to create or imply a special legal status between the organizations."[16] In these kinds of situations, each organization might be responsible for a certain aspect of the project.

iv) Contractors

In the Current Policy and the Proposed Guidance, CRA permits charities to contract work out to an organization or individual in another country to provide goods and services to achieve the charitable purpose of the charity. CRA advises charities that before contracting out the work, charities should have a clear idea of what the project is that the charity is attempting to carry out and how long it will take to complete from beginning to end. This is necessary to ensure that precise instructions are given to the contractor.

b) "Own Activities" Test

The key component of the Proposed Guidance is the requirement that a charity must meet the "own activities test." This test is defined as follows:

> Whether a charity works through its staff or through intermediaries, the Act requires a charity to devote all of its resources to charitable activities carried on by the organization itself.[37]

The Proposed Guidance provides some indicators that CRA considers when determining whether an arrangement with an intermediary is acceptable. They are divided into six "measures of control":

i) Written Agreements

Although there is no formal requirement for a written agreement, CRA views them as an effective way to help meet the "own activities test."

ii) Description of Activities

A statement of activities is required to show that the charity is able to give "a clear, complete, and detailed description of that activity."

[37] *Supra* note 35 at para. 48.

iii) Monitoring and Supervision

One way a charity can demonstrate it controls the use of its resources and meets the “own activities test” is to have an “ongoing relationship with its intermediary through regular monitoring and supervision.”

iv) Ongoing Instruction

The charity should be providing ongoing instructions to the intermediary to demonstrate that it continues to control the activities.

v) Periodic Transfers

Charities should retain the right to discontinue the transfer of funds and to have unused funds returned if the charity is not satisfied with the reporting, progress, or outcome of an activity.

vi) Separate Activities and Funds

A charity must be able to distinguish between its activities and those of its intermediary when carrying on activities through an intermediary:

c) Other Considerations

The Proposed Guidance indicates that agreements will generally need fewer of these measures of control when the resources (because of their nature) can only be used for charitable purposes, which is consistent with CRA’s longstanding informal “charitable goods policy”, i.e. goods that inherently can only be used for a charitable purpose or purposes would not necessarily require a written agreement.

The Proposed Guidance also indicates that charities must keep adequate books and records in Canada, in either English or French, failing which the charity could be subject to sanctions under the Act, including the loss of charitable status. However, CRA does acknowledge that in some situations, i.e. war, famine, natural disasters, it may be difficult or impossible to obtain the required records. In these situations, the charity must demonstrate that it made all reasonable efforts

to obtain the necessary records. The Proposed Guidance also explains the requirements for books and records with regards to agency, contracts for services and joint venture arrangements.

The Proposed Guidance points out that the disbursement quota is not affected by whether the charity is carrying on its own activities or not, and applies to charitable organizations operating outside of Canada in the same way that it applies to those operating in Canada. CRA notes that calculating the disbursement quota could be difficult when working jointly or in partnership with another organization.

The Proposed Guidance concludes with a number of appendices, which provide more detailed guidance in particular situations. In Appendix A - Applications for Charitable Registration to Provide Disaster Relief, CRA acknowledges the timely nature of disaster relief and priority is typically assigned to these files. In Appendix B - Capacity Building, CRA adopts an approach which reflects a practical understanding of the broad extent and application of capacity building that allows charities to help communities in dealing with the larger underlying root causes of many of the problems with which they are confronted. In Appendix C - Additional Guidelines for Joint Ventures, CRA lists some factors that will be considered when determining whether or not a charity meets the "own activities test" when working through joint ventures. In Appendix D - Transferring Property to a Non-Qualified Donee, CRA discusses exceptions to situations where a charity may wish to transfer real or capital property to a non-qualified donee, which is prohibited under the Act. Finally, Appendix E - Checklist of the Elements of a Written Agreement, provides a checklist for charities to use to ensure that their agreements contain the "minimum elements necessary" for compliance with the Act.

d) Summary Comments

The Proposed Guidance contains many improvements over the Current Policy by better reflecting developments in the world in which charities operate. It also

clarifies much of the previously ambiguous wording. One of the most noticeable additions in the Proposed Guidance is a section on compliance with Canada's anti-terrorism legislation, which was not addressed in the Current Policy. The Proposed Guidance, however, still has challenging aspects to it, such as the burdensome requirement that an intermediary produce receipts, invoices and vouchers at the end of a charitable program, particularly when the charitable program involves utilization of contractors. In addition, the "own activities" requirement interpretation by CRA unduly restricts Canadian charities' ability to participate in charitable activities overseas. As well, the requirement that books and records be kept in Canada is particularly onerous when the information required by the CRA to determine compliance is normally readily available through electronic records. The ability to display that information by electronic records in Canada should satisfy the books and records requirement but is not recognized by the CRA in the Proposed Guidance.

Despite these deficiencies, the Proposed Guidance constitutes an important improvement over the Current Policy and as such will need to be carefully studied by charities and their legal advisors.

E. RECENT TECHNICAL INTERPRETATIONS AND DECISIONS UNDER THE *INCOME TAX ACT*

The following is a brief overview of some of the more important technical interpretations by CRA and decisions of the Federal Court of Appeal under the ITA over the last 12 months, generally organized in chronological order and with particular emphasis on technical interpretations issued by CRA with regard to gifting.

1. Donating the Temporary Use of a Cottage is Not a Gift[38]

In a technical interpretation dated November 12, 2008 (CRA Document #2008-026772)[39], CRA confirmed its position originally outlined in *Income Tax Technical News* No. 17 (April 26,

[38] Excerpted from Karen J. Cooper, "Donating the Temporary Use of a Cottage is not a Gift" in *Charity Law Update* (November 2008) online: http://www.carters.ca/pub/update/charity/08/nov08.pdf.
[39] Technical Interpretations are only available through commercial subscription or a direct request to CRA.

1999)[40] that the gratuitous loan of property, including money or a cottage, is not a gift for purposes of sections 110.1 and 118.1 of the ITA*,* since a loan does not constitute a transfer of property. However, it is possible for a charity to pay rent or interest on a loan of property and later accept the return of all or a portion of such payment as a gift, provided the return of the funds is voluntary. CRA requires that each transaction be separate and independent of the other in order for the ultimate return of the payment to qualify as a gift. CRA has also indicated that the rent or interest payments in such circumstances would have to be included in the taxable income of the donor, thereby effectively negating the benefit of the donation tax receipt.

2. Split Receipting for Cemetery Plots[41]

On November 24, 2008, CRA issued a technical interpretation (CRA Document #2008-028417) which deals with the issuance of charitable donation receipts in a situation where a member-donor is entitled to pay less for a cemetery plot than a non-member. CRA states that in applying the proposed split-receipting amendments to this kind of situation, the "eligible amount" of the gift will be reduced by the value of the "advantage" provided to the members, which would include the right to purchase a cemetery plot at a discount. Unfortunately, the technical interpretation provides little specific guidance, nor any clear facts. In this regard, it is assumed that the donation receipts were being provided in respect of the annual membership fees paid by members to a synagogue or a church and that one of the benefits of such membership included a discount on the price of a cemetery plot.

Since the definition of "advantage" in proposed subsection 248(32) of the ITA[42] provides that the amount of the advantage is generally the value, at the time the gift is made, of any property, service, compensation or other benefit received, or expected to be received in the future, by the donor, any donation receipt issued in respect of the membership fee should be reduced to reflect the value of the discount. It is therefore important that registered charities keep careful records of the valuation used of any advantage identified with regard to membership fees in order to avoid the problems that some charities have encountered in this regard.

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[40] For more information, see *Income Tax Technical News* No. 17 (May, 1999) online: http://www.cra-arc.gc.ca/E/pub/tp/itnews-17/README.html.

[41] For more information, see Karen J. Cooper "Split Receipting for Cemetery Plots" in *Charity Law Update*, (December 2008) online: http://www.carters.ca/pub/update/charity/08/dec08.pdf.

[42] The proposed amendments have not yet passed into law, but it is expected that they will be in place by sometime in 2010.

3. Federal Court of Appeal Decides Operating a Hostel not Charitable[43]

In a December 2008 decision, the Federal Court of Appeal upheld the Minister of National Revenue's (the "Minister") decision to revoke the charitable status of Hostelling International Canada – Ontario East Region.[44] The organization had been registered as a charity since 1973 for the purpose of promoting education by providing affordable accommodation to youth in order to encourage them to have a greater knowledge and appreciation of the world.

As a result of a CRA audit of the organization, the Minister issued a notice of intention to revoke the charitable status of the organization in 2006. This decision was confirmed by the Minister in January 2008 after reviewing the organization's objection. The Minister took the position that operating a hostel is an unrelated business activity, and as such the organization failed to devote all of its resources to charitable activities.

In upholding the Minister's decision, the Court rejected the hostel's argument that facilitating travel by providing low-cost accommodation is a charitable activity that promotes the advancement of education. The Court held that simply providing an opportunity for people to educate themselves by making available tourist accommodation is not sufficient for the activity to be charitable. Although the organization argued that the Minister should have annulled its charitable status, instead of revoking it, the Court noted that the power of the Minister to annul the charitable status of an organization is a discretionary one and it was open for the Minister to proceed with a revocation in this case.

4. Gifts of Marketable Securities – Enduring Property?[45]

In a technical interpretation dated January 15, 2009, (CRA Document #2008-0268731E5), CRA considered whether the donation of marketable securities to a registered charity may be characterized as a gift of enduring property and, if so, would the charity be prevented from disposing of the marketable securities and maintaining the substitute property as enduring

[43] For more information, see Theresa L.M. Man in "Federal Court of Appeal Decides Operating a Hostel not Charitable" in *Charity Law Update* (February 2009) online: http://www.carters.ca/pub/update/charity/09/feb09.pdf
[44] The decision *Hostelling International Canada – Ontario East Region v. Minister of National Revenue*, 2008 FCA 396, is available online at: http://decisions.fca-caf.gc.ca/en/2008/2008fca396/2008fca396.pdf.
[45] Excerpted from Theresa L.M. Man, "Gifts of Marketable Securities – Enduring Property?" in *Charity Law Update* (January 2009) online: http://www.carters.ca/pub/update/charity/09/jan09.pdf.

property (i.e.,10 year gifts, bequests, testamentary gifts of RRSPs and life insurance, and inter-charity transfers of such property, as well as 5 year inter-charity gifts to charitable organizations are all excluded from the 80% disbursement quota). CRA confirmed that gifts of marketable securities will qualify as enduring property if the donor provides written direction at the time of the donation that the securities are to be held by the charity for ten years or longer. Provided that the donor has given the charity permission to dispose of the securities within the 10-year period, property later substituted for the original securities will also be considered enduring property. Charities receiving gifts of marketable securities should ensure that donors include the permission to substitute property at the time of the donation.

5. Gift of Capital Property by Will[46]

In a technical interpretation dated February 4, 2009, regarding gifts of capital property by will (CRA Document # 2008-027364), CRA confirmed that proposed subsections 118.1(5.4) and (6) of the ITA as contained in an earlier version of Bill C-10[47] will override the application of paragraph 70(5)(a) of the ITA. Proposed subsections 118.1(5.4) and (6) of the ITA provide that where a Canadian resident individual dies making a bequest of a capital property by his will to a registered charity and the fair market value ("FMV") of the capital property immediately before the individual's death exceeds its adjusted cost base ("ACB"), the individual's legal representative can designate in the deceased's terminal income tax return an amount between the FMV and the ACB, which will be deemed to be the individual's proceeds of disposition of the capital property, and for the purpose of proposed subsection 248(31) of the ITA, the FMV of the gift. Paragraph 70(5)(a) of the ITA deems each capital property owned by a deceased taxpayer to have been, immediately before his or her death, disposed of by the deceased taxpayer for proceeds of disposition equal to its FMV immediately before his or her death. CRA notes that paragraph 70(5)(a) of the ITA is a general provision and states that it is its view that it is the amount that is designated by the legal representative pursuant to subsection 118.1(6) of the ITA that would be used in calculating the amount of the capital gain arising on the deemed disposition of the gifted property to be included in the individual's final return.

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[46] Excerpted from Karen J. Cooper, "Gift of Capital Property by Will" in *Charity Law Update* (March 2009) online: http://www.carters.ca/pub/update/charity/09/mar09.pdf.
[47] *Supra* note 42.

6. Valuation of Gifts of Life Insurance – update[48]

In a technical interpretation dated February 25, 2008 (CRA Document # 2008-028446), CRA had changed its previous position regarding the valuation of gifts of life insurance and had indicated that the factors listed in paragraph 40 and 41 of IC 89 3[49] should be taken into consideration when determining the eligible amount of a gift and that paragraph 3 of IT 244R3[50] should now be read taking into account this new position.

Subsequent to the February 2008 technical interpretation, CRA was asked at a conference in October 2008 to consider two situations where a taxpayer might acquire a life insurance policy to meet a temporary need but intends eventually to make a gift of the policy: (1) an individual who is the owner of a business acquires a life insurance policy, under which his own life is insured, in order to cover his taxes at death but 2 years after acquiring the policy, he sells his business and pays the taxes arising from the sale - less than three years after acquiring the life insurance policy, he gifts it to a registered charity; and (2) an individual who is aware that the cost of life insurance increases with age decides to purchase a life insurance policy with the intention of gifting it later to a registered charity - after holding the policy for eight years, he creates a private charitable foundation and gifts his policy to the foundation, which is a registered charity, and he will continue to pay the premium each year. In both situations, the life insurance policy is fully assigned to a qualified donee who becomes the policyholder and the beneficiary. CRA was asked whether s. 248(35) (the proposed deemed disposition at cost rules) of the ITA should not apply and whether it would be appropriate to add to the exceptions provided in subsection 248(37) of the ITA, the donation of life insurance policies?

CRA indicated that it was of the view that proposed subsection 248(35) of the ITA on the deemed disposition rules will apply to establish the fair market value of the life insurance policies in question and that whether or not it is appropriate to add the gifting of life insurance policies to the list of exceptions enumerated in proposed subsection 248(37) of the ITA is a matter of tax policy and the responsibility of the Department of Finance. However, CRA noted that with respect to the payment of premiums, IT-244R3 8 states that "if the premiums on the

[48] Excerpted from Karen J. Cooper in "Valuation of Gifts of Life Insurance – Update" in *Charity Law Update* (April 2009) online: http://www.carters.ca/pub/update/charity/09/apr09.pdf.
[49] IC89-3 (August, 1985) online: http://www.cra-arc.gc.ca/E/pub/tp/ic89-3/ic89-3-e.html.
[50] IT-244R3 (September, 1991) online: http://www.cra-arc.gc.ca/E/pub/tp/it244r3/it244r3-e.html

policy are paid directly to the insurance company at the request of, or with the concurrence of, the donee, this action is considered to be constructive payment of a donation to the donee and therefore a charitable gift for the purposes of the Act." As such, CRA was of the view that proposed subsection 248(35) of the ITA will not have an impact on the cash payment of the premiums that the individual will continue to make.

7. Directed Gift to Municipality[51]

In a technical interpretation, dated March 16, 2009 (CRA document #2008-030447), CRA considered whether a municipality could issue donation receipts in circumstances where a gift received by the municipality is directed by the donor to a separate non-profit organization ("NPO"). The NPO was responsible for the maintenance of a building on a site owned by the municipality and to which it had been delegated the operation of several municipal programs. CRA indicated that a municipality in Canada is a "qualified donee" and the municipality may issue an official tax receipt for the eligible amount of the gift. Further, CRA indicated that donations can be receipted by a municipality in Canada on behalf of an organization which operates under the authority of the municipality (e.g., a committee established by a municipal bylaw), provided the municipality retains discretion concerning how the donated funds are to be spent. If the municipality, though, is merely collecting funds from donors on behalf of the NPO which is entitled to the property so transferred, the municipality would not be in receipt of a gift and could not issue a donation receipt.

8. Gifting Artwork[52]

In a technical interpretation, dated March 30, 2009, (CRA Document #2008-030487), CRA was asked to provide its comments with respect to the following questions:

1. Can a donation receipt for a charitable gift be issued to a person other than the donor?

[51] For more information see Karen J. Cooper, "Directed Gift to Municipality" in *Charity Law Update* (April 2009) online: http://www.carters.ca/pub/update/charity/09/apr09.pdf.

[52]Fore more information, see Karen J. Cooper "Gifting Artwork from an Artist's Inventory" in *Charity Law Update* (June 2009) online: http://www.carters.ca/pub/update/charity/09/jun09.pdf. See also *IT288R2 - Gifts of Capital Properties to a Charity and Others,* (January 16, 1995) online: http://www.cra-arc.gc.ca/E/pub/tp/it288r2/README.html.

2. What are the consequences of gifting art to an individual so he or she can in turn gift to a registered charity?

3. Can artwork from an artist's inventory be transferred on a tax deferred basis to a spouse?

4. What are the consequences of gifting artwork from an artist's inventory to a registered charity?

In reply, CRA fist confirmed that a charitable donation receipt can only be issued to the actual donor. Secondly, CRA stated that if a person is given a work of art and is directed to transfer the property to a charity, the transfer of property to the charity will not qualify as a gift because the transfer would not be voluntary, and therefore the person will not be entitled to a tax credit. Thirdly, CRA explained that subsection 73(1) of the ITA permits tax deferred transfers between spouses of capital property if the transfer is considered a "qualifying transfer" as defined in subsection 73(1.01) of the ITA, which definition does not include a transfer of inventory. Accordingly, when an artist makes a gift of inventory to his spouse or to a charity, subject to the exception below, there will be a deemed disposition of that inventory for an amount equal to the fair market value of that inventory. This amount must be included in the artist's income and will be subject to income tax. Where transferred to a spouse, the spouse may subsequently gift the same property to a registered charity and receive an official donation receipt for the eligible amount of the gift. Finally, CRA indicated that if an artist makes a gift directly to a registered charity of a work of art from his or her inventory, the individual may designate an amount under subsection of the ITA 118.1(7) that cannot be greater than the fair market value of the property, nor less than its cost amount which will be deemed to be the individual's proceeds of disposition and the fair market value of the gift for tax purposes.

9. Clarification by CRA on Enduring Property for Purposes of the Disbursement Quota[53]

The term "enduring property" (i.e., 10 year gifts, bequests, testamentary gifts of RRSPs and life insurance, and inter-charity transfers of such property, as well as 5 year inter-charity gifts to charitable organizations are all excluded from the 80% disbursement quota) was introduced in

[53] For more information, see Theresa L.M. Man, "Enduring Property and the Disbursement Quota" in *Charity Law Bulletin* No. 171 (July 29, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb171.pdf.

the 2004 federal budget (which became law in 2005) and has had a substantial impact on the calculation of the disbursement quota of charities and the ability of charities to encroach on ten-year gifts to meet its 3.5% disbursement quota.[54] Since the introduction of this term and other related rules on the disbursement quota, there have been many questions that the charitable sector has raised concerning the treatment of enduring property for disbursement quota purposes. In this regard, on April 20, 2009, CRA released a document entitled "Treatment of Enduring Property for Purposes of the Disbursement Quota" (the "CRA Document"),[55] setting out answers to nine frequently asked questions on this issue.

The first question concerned whether or not there was an issue where a fund agreement in an endowment portfolio defined income to include capital gains. Some agreements made no distinction between interest, dividends, realized and unrealized capital gains. CRA explained that both realized and unrealized capital gains relating to the original property gifted to the charity, or to property substituted for the gift, form part of the gift that is subject to the holding period. Therefore, where a fund agreement allows a charity to expend these capital gains (both realized and unrealized) prior to the end of the ten-year period, the gift may not qualify as a ten-year gift in the first place, unless such expenditures do not exceed the charity's 3.5% disbursement quota.

The second question raised the issue of whether or not the definition of enduring property in the ITA permitted the encroachment on capital within the minimum ten-year holding period to meet the disbursement quota when the terms of the gift permit encroachment.

In this regard, it is possible under the ITA for a ten-year gift to be subject to a trust or direction to permit the original recipient charity (or a subsequent transferee charity) to expend the ten-year gift before the end of the specified holding period to the extent of an amount determined for the charity's 3.5% disbursement quota. As such, where a ten-year gift is not subject to a donor's trust or direction permitting encroachment, it would not be permissible to encroach on the ten-year gift at all. As long as the encroachment on a charity's ten-year gifts does not exceed what is in the charity's "capital gains pool," the ITA permits the entire amount encroached to be applied

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[54] The 2004 federal budget was released in March 2004. Draft amendments to the *Income Tax Act* (Canada) were released on September 16, 2004, which were revised on December 6, 2004. The proposed amendments were introduced as Bill C-33, which was enacted on May 13, 2005 as the *Budget Implementation Act, 2004, No. 2.* R.S.C. 2005, c. 19.

[55] Available on CRA's website at http://www.cra-arc.gc.ca/tx/chrts/plcy/csp/csp-e10-fqs-eng.html.

towards meeting the charity's 3.5% disbursement quota. The capital gains pool is a notional account of all realized capital gains derived from the disposition of a charity's enduring property. This is effected by allowing a charity to reduce the 80% disbursement quota obligation in A.1 of the disbursement quota under subsection 149.1(1) by an amount claimed by the charity that does not exceed the lesser of 3.5% disbursement quota and the charity's capital gains pool.

Since a donor's trust/direction may allow a charity to encroach on a ten-year gift up to 3.5% of the disbursement quota, it is conceptually possible that the encroachment on a ten-year gift for the purpose of meeting its 3.5% disbursement quota may in fact exceed what is in the charity's capital gains pool. However, in that situation, the encroachment that is beyond the capital gains pool (the "excess amount") would be included in A.1 of the disbursement quota and therefore create a disbursement quota obligation on the charity. The charity would thus be required to expend 80% of the excess amount in the year under A.1(a)(i) of the disbursement quota formula, which disbursement quota obligation so created would be met by the expenditure itself in that same year. This would only leave 20% of the excess amount available towards meeting the 3.5% disbursement quota.

In CRA's response to question 3 in the CRA Document, CRA indicated that if a charity does not track its capital gains pools, this will inhibit the charity's ability to encroach on enduring property. CRA explained that tracking the capital gains pools allows a charity to reduce its 80% disbursement quota obligation under A.1 of the disbursement quota formula (i.e., enduring property spent or transferred to a qualified donee in a taxation year). Therefore, if a charity does not track its capital gains pools, it will be unable to determine the amount of the reduction that it is entitled to. CRA recommended that charities declare their capital gains realized on the disposition of enduring property so that they would be able to calculate and claim a reduction in the disbursement quota in a subsequent taxation year.

The fourth question discussed whether or not charities are required to track all their ten-year gifts to determine whether or not their holding periods have expired. A ten-year gift is a gift that is subject to a trust or direction imposed by the donor, requiring the gift (or property substituted for the gift) be held by the charity for a period of time that is at least ten years from the date when the gift was made (the "hold period").

CRA confirmed that it is necessary for a charity to track each ten-year gift separately in order to determine when the hold periods in each case would expire. This tracking is necessary in all situations, even though it is possible that a charity's endowment fund may consist of various ten-year gifts donated at different points in time and it is possible for donors to impose different hold periods to each of these ten-year gifts.

The fifth question raised the issue of the acceptability for a charity to encroach on capital to meet its disbursement quota, and would the existence of any disbursement excesses have an impact on the amount a charity can encroach. A charity can decide *when* and *whether* to encroach on its ten-year gifts in order to meet its 3.5% disbursement quota, and if there is an encroachment, *how much* to encroach.[56] CRA's response to question 5 clarified that even where a charity has disbursement excess, the charity has the discretion to encroach on the ten-year gifts in meeting its 3.5% disbursement quota, provided that the terms of the ten-year gift permits encroachment.

The concern in question six was where a charity's fund agreements may include the ability to encroach on capital to cover its administration fees and investment management fees. In situations where the trust/direction permits a charity to encroach on capital to cover its administration fees and investment management fees, CRA responded that this would be permissible provided that the trust/direction restricts the encroachment for such fees up to the charity's 3.5% disbursement quota. If the permitted encroachment is not limited to the charity's 3.5% disbursement quota, CRA's response to question 6 indicated that the gift would not qualify as a ten-year gift in the first place. In other words, in order to qualify as a ten-year gift, the trust/direction must restrict the encroachment up to the charity's 3.5% disbursement quota. Furthermore, CRA clarified that any encroachment on capital will factor into the disbursement quota calculation and that amounts spent on administration and investment management fees are not charitable expenditures and cannot be used to satisfy the disbursement quota.

Question seven pertained to the problem where a charity is encroaching on capital if it needs to recognize it on line 5710 as amounts of enduring property spent in the taxation year and that these amounts will create an 80% disbursement quota requirement in the following year. CRA clarified in its response to question 7 in the CRA Document that enduring property expended in a

[56] This is because of the phrase "an amount claimed by the charity" in A.1(b) of the disbursement quota formula.

taxation year will impact the charity's disbursement quota requirement in the *same* taxation year in which the property is expended, but it would not create an 80% disbursement quota requirement in the *following* year. This means that upon the expenditure of an enduring property, the expenditure will create a disbursement quota obligation on the charity so that it is required to expend 80% of the enduring property in the year of the expenditure. The disbursement quota obligation so created would be met by the expenditure itself in that same year.

Question eight addressed the current financial crunch for charities, as it asks whether a charity should apply for relief or just continue with filing a T3010, where it will be unable to meet its disbursement quota in 2009. CRA's response reminded that a charity has the obligation to file its T3010 annual information return and it may lose its charitable registration if the form is not filed on time. However, CRA also reminded that a charity may apply for relief under subsection 149.1(5) of the ITA if it is unable to meet its disbursement quota due to unforeseen circumstances that are beyond its control.

Lastly, question 9 related to a situation where a charity encroaches on a ten-year gift, whether the entire ten-year gift would be required to be included in A.1 of the formula for the charity's disbursement quota for the year, or only the portion of the gift that was expended in the year that must be included in the calculation. CRA indicated that if the terms of the fund agreements permit the charity to expend a portion of the property gifted in excess of its 3.5% disbursement quota, the gift would not qualify as enduring property in the first place and 80% of the gift would be required to be included the charity's 80% disbursement quota and create an 80% disbursement requirement in the taxation year subsequent to the year in which the gift was made. However, where a portion of an enduring property is expended, only 80% of the amount spent and 100% of amount transferred to qualified donees would be required to be reflected in A.1 of the formula for the charity's disbursement quota in the taxation year that the amount was expended or transferred. Similarly, the remainder of the gift would not be included in the charity's A.1 in the formula for the charity's disbursement quota until is expended or transferred to a qualified donee.

10. Charity Deregistered for Carrying On an Unrelated Business Activity[57]

On May 6, 2009, the Federal Court of Appeal upheld the Minister of National Revenue's decision to revoke the charitable status of The House of Holy God.[58] As a result of a 2006 CRA audit of the organization, the Minister issued a notice of intention to revoke the charitable status of the organization in 2007 for operating an unrelated business by having "solely engaged in the business of producing and selling maple syrup and maple syrup products."

A charity can carry on a related business provided that it is either (1) linked to the charity's purpose and is subordinate to that purpose or (2) run substantially by volunteers. In this case, the Court found that the organization failed to meet either test.

The Minister took the position that the maple syrup business was not linked to the objects of the organization, nor was it run substantially by volunteers. The Court rejected the organization's argument that there was a direct relationship between its charitable objects and the activities of food production because no evidence was presented to show that the carrying on of a maple syrup activity was an element of religious doctrine, or that the organization carried on any teaching activities.

The organization argued that the maple syrup business was a related business because the profit generated from the business was deposited in its Rainbow Fund Raising Account for use by the organization for the construction of a community centre in the future. However, in light of the Court's decision in 2003 in the *Earth Fund* case[59], the Court rejected the organization's argument because the profit designation test is irrelevant when determining whether an activity is a related business.

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[57] For more information, see Theresa L.M. Man "Charity Deregistered For Carrying On an Unrelated Business" in Charity Law Update (June 2009) online: http://www.carters.ca/pub/update/charity/09/jun09.pdf.
[58] To review a copy of the decision *The House of Holy God v. Attorney General of Canada*, 2009 FCA 148, see http://decisions.fca-caf.gc.ca/en/2009/2009fca148/2009fca148.html.
[59] 2002 FCA 498

11. CRA Withdraws Compliance Agreement[60]

In the May 20, 2009 decision of *Christ Apostolic Church of God Mission International v. Canada (Minister of National Revenue)*[61] ("*Christ Apostolic Church*"), the Federal Court of Appeal held that the CRA could withdraw a compliance agreement it had made with Christ Apostolic Church of God Mission International in the course of an audit of its charitable status. As a result, the Court upheld CRA's decision to issue a notice of intention to revoke the church's charitable registration.

In general, compliance agreements are agreements that are negotiated between CRA and a registered charity as a result of a charity's failure to comply with its requirements under the ITA. Typically, a deficiency is identified as a result of a CRA audit, and a compliance agreement provides the charity with a chance to address and correct such non-compliance.

The compliance agreement is one of several tools that may be used by CRA to address issues of non-compliance.[62] Listed in terms of progressive severity, they include: (1) education; (2) compliance agreement; (3) sanction (e.g. financial penalty or suspension); and (4) revocation. CRA may choose the type of tool that is appropriate for the seriousness of the non-compliance, and therefore, there is no general principle that CRA must address non-compliance in a progressive or gradual fashion.

While there is no rule that CRA cannot change from one method to another, there is also no indication in CRA's guidelines for applying sanctions that compliance agreements, as duly negotiated and signed by both parties, will not be binding. This was the issue that the Federal Court of Appeal had to decide in *Christ Apostolic Church*.

The Court did not find any merit in the argument that CRA could not unilaterally withdraw the compliance agreement signed at the request of the auditor during the course of an audit, nor did the court agree that the requirements of natural justice and procedural fairness had been breached

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[60] For more information, see Terrence S. Carter, "Federal Court of Appeal Allows CRA to Withdraw Compliance Agreement," in *Charity Law Bulletin* No. 170 (July 29, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb170.pdf.
[61] 2009 FCA 162.
[62] For more information, see Canada Revenue Agency, *Guidelines for Applying the New Sanctions*, online: http://www.cra-arc.gc.ca/tx/chrts/plcy/nwsnctns-eng.html.

by not allowing the charity a chance to argue that the compliance agreement was sufficient sanction. The court agreed with CRA that the ability of the charity to rely on the compliance agreement was subject to CRA's discretion and that having reviewed the auditors report, CRA could take the position that the charity's non-compliance could not be remedied by the agreement.

Unfortunately, the Court's decision now provides CRA with authority to change a particular sanction from a compliance agreement, which has been signed by both CRA and a registered charity, directly to the revocation of charitable status if it so chooses. More specifically, the decision indicates that a compliance agreement can be unilaterally withdrawn by CRA and, therefore, is obviously not binding on CRA.

This decision creates a considerable amount of uncertainty for registered charities that are presented with the option of entering into a compliance agreement with CRA. Notwithstanding the possibly unique facts of this case, charities need to be aware that CRA may now, if it wishes, withdraw a compliance agreement and revert to more severe types of sanctions, including revocation.

F. OTHER FEDERAL LEGISLATION AFFECTING CHARITIES

The following is a brief overview of some of the more important federal legislative initiatives affecting charities.

1. Update on New Not-for-profit Canada Corporations Act[63]

On December 3, 2008, one day prior to Parliament being prorogued, Bill C-4, *An Act respecting not-for-profit corporations and certain other corporations,* more commonly referred to as the *Canada Not-for-profit Corporations Act* ("the old Bill C-4"), received first reading in the House of Commons of Canada before dying on the order paper.

[63] For more information, see Jane Burke-Robertson, "Bill C-62: Changes Afoot for Federal Non-Profit Corporations" in *Charity Law Bulletin* No. 139 (June 25, 2008) online: http://www.carters.ca/pub/bulletin/charity/2008/chylb139.htm, which summarizes the earlier Bill C-62. See also Jacqueline M. Demczur and Terrance S. Carter, "New *Canada Not-For-Profit Corporations Act* and Its Impact on Charitable and Non-Profit Corporations" in *Charity Law Bulletin* No. 60 (December 30, 2004) online: http://www.carters.ca/pub/bulletin/charity/2004/chylb60-04.pdf, which summarizes the earlier Bill C-21.

The Old Bill C-4 was reintroduced as Bill C-4, ("the New Bill C-4"), on January 28, 2009, which did not contain any substantive changes from the Old Bill C-4.

The New Bill C-4 is intended to replace Parts II and III of the current *Canada Corporations Act*,[64] a statute first enacted in 1917 and substantively unchanged since that time, which Parts govern federal non-share capital corporations. This is the fourth attempt by the Federal Government to reform the *Canada Corporations Act*, with the Old Bill C-4 (2008) having died on the order paper in the House of Commons when Parliament was prorogued as indicated above and earlier Bill C-62 (2008) (introduced by the Conservatives in June 2008) and Bill C-21 (2004) (introduced by the Liberals) each dying on the order paper in the House of Commons when Parliament was dissolved for a general election.

The New Bill C-4 finally received third reading in the Senate on June 23, 2009 and received Royal Assent on the same day. The provisions of the New Bill C-4, though, are not yet in force, and will only come into force on a day or days still to be fixed by order of the Governor in Council. This is not expected until the regulations proposed by Industry Canada have been approved. Draft regulations have been available from Industry Canada since January, 2009.[65] However, changes are still expected to be made to the draft regulations. In this regard, the New Bill C-4 provides that certain details will be set out in the regulations, including prescribed time periods, corporate name regulations, options for providing notice of members' meetings, absentee voting and service fees.[66]

An analysis of the New Bill C-4 is beyond the scope of this paper. However, two things should be noted at this time. First, the content of the New Bill C-4 is generally similar to the original Bill C-21 introduced in 2004 with certain exceptions. Second, once the New Bill C-4 comes into force, all existing federal non-share capital corporations subject to Part II of the *Canada*

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[64] R.S.C. 1970, c. C-32.

[65] The proposed regulations are available from Industry Canada, online: http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs04099.html . See also the explanatory note by Industry Canada, online: http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs02683.html.

[66] For more information see Jane Burke-Robertson, "Draft Regulations Under the Canada Not-For-Profit Corporations Act" in *Charity Law Update* (October 2009) online: http://www.carters.ca/pub/update/charity/09/oct09.pdf.

Corporations Act will be required to apply for continuance under the New Bill C-4 within three years of it coming into force.

2. Proposed Consumer Product Safety Act[67]

The charitable sector has raised concerns with regard to Bill C-6, the *Canada Consumer Product Safety Act* (the "Bill")[68], which was passed by the House of Commons on June 12, 2009 and is currently being debated by the Senate. The Bill, which has the objective of protecting the public by addressing dangers to human health or safety that are posed by consumer products, intends to establish a regulatory framework that will prohibit the sale of certain products and set requirements for testing, record-keeping and responding to incidents. There is no exemption, however, for charities or not-for-profit organizations.

The record-keeping requirements would include documenting the identity and address of the person from whom they obtained the product and the location where and the period during which they sold the product for the purpose of assisting Health Canada in obtaining information in the event of an incident. However, the requirements are raising concerns within the charitable sector regarding the ability of charities, such as those who run thrift stores or other types of donation programs, to comply. In this regard, the Bill would seem to prohibit charities from receiving anonymous in-kind donations of consumer products if they are being sold for a commercial purpose within the meaning of the Bill.

More clarity is required in order to assess the full impact of this Bill on charities and not-for-profit organizations, and as such, it is unknown at this time whether the Senate will provide the necessary clarification.

G. ONTARIO LEGISLATION AFFECTING CHARITIES

The following is a brief overview of some of the more important Ontario legislative initiatives affecting charities in Ontario.

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[67] Excerpted from Nancy E. Claridge and Terrance S. Carter, "Proposed Consumer Product Safety Act Raises Concerns for Charities" in *Charity Law Update* (July/August 2009) online: http://www.carters.ca/pub/update/charity/09/julaug09.pdf.

[68] For further information about the status of the Bill and other related information, go to: http://www2.parl.gc.ca/Sites/LOP/LEGISINFO/index.asp?Language=E&Session=22&query=5655&List=toc.

1. Ontario Corporate Update

By way of background, in the spring of 2007, the Ontario Ministry of Government and Consumer Services ("Ministry") announced that it was undertaking a project to review and revise the *Ontario Corporations Act* ("the OCA"). Currently, the OCA provides the statutory framework governing the creation, governance, and dissolution of non-share capital corporations, including charitable corporations in Ontario. The statute was originally enacted in 1907 and was last substantially updated in 1953. Many of its provisions are now severely outdated and are no longer relevant to the not-for-profit sector in Ontario. The Ministry has explained that it is planning to reform this area of the law and "develop a new legal framework to govern the structure and activities of charities and not-for-profit corporations" in Ontario.

As the first step of this process, the Ministry released three consultation papers in 2008, which identified a number of areas of potential reform. These consultation papers, entitled *Modernization of the Legal Framework Governing Ontario Not-For-Profit Corporations,* invited comments and suggestions from sector stakeholders, as well as the general public at large.

According to Allen Doppelt, senior counsel for the Ministry of Small Business and Consumer Services, the new legislation, to be entitled the Ontario *Not-for-profit Corporations Act,* is currently in the drafting stage, with a first reading expected in late Spring, 2010. The new legal framework anticipated in the pending legislation will be essential to ensure that Ontario will continue to be an attractive jurisdiction for the incorporation of non-share capital corporations, given the significant corporate reform that has occurred at the federal level.

2. Bill 212, Good Government Act 2009, Proposed Reforms to Legislation Concerning Charities

On October 27, 2009, Bill 212, the *Good Government Act, 2009* ("Bill 212")[69] was introduced in the Ontario legislature. Bill 212 contains significant reforms for the charitable sector in the Province of Ontario. The most important among these proposed changes is the repealing of the *Charitable Gifts Act,* which currently limits the ability of charities in Ontario to own more than a 10% interest in a business. The *Charitable Gifts Act* has long been criticized for its lack of clarity

[69] The proposed Bill 212 is available online at: http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=2235&detailPage=bills_detail_the_bill.

and its appropriateness in light of it having been enacted in 1949 in part to ensure that a charity would not have a controlling interest in a business.[70]

Additionally, Bill 212 proposes amendments to the *Charities Accounting Act*, which would expand powers of the Ontario Public Guardian and Trustee ("OPGT") to require documents and make inquiries where an executor or trustee holds a substantial interest in an entity, for instance, where an executor or trustee holds more than 20% of the voting rights or equity of a corporation through shares. The amended provisions would allow the OPGT to apply to the Superior Court of Justice for an order to compel production of documents to provide information regarding the management, operation, ownership or control of the entity.

As well, section 8 of the *Charities Accounting Act*, which had permitted the OPGT to vest property in its name if the property of a charity had not been used for charitable purposes within 3 years, has been repealed. In its place, a new section 8 has been proposed which provides that a person who holds an interest in real or personal property for a charitable purpose must use the property for the charitable purpose, although there is some uncertainty regarding how the new language is to apply.

Other proposed changes include an amendment to the *Accumulations Act*[71] which would add a section stating that the common law and statutory rules regarding accumulations do not apply and shall be deemed never to have applied to a trust created for a charitable purpose. Lastly, the *Religious Organizations' Lands Act*[72] would be amended to remove the 40 year term limit for which a religious organization may lease land.

Although some clarification is needed before Bill 212 becomes law, the proposed amendments are welcome changes to various provincial acts which have often been criticized for posing unnecessary restrictions with regard to charitable activities in Ontario.

[70] For more information, see Donald J. Bourgeois, "*The Charitable Gifts Act*: A Commentary" in *Charity Law Bulletin* No. 174 (September 29, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb174.pdf.
[71] R.S.O. 1990, c. A.5.
[72] R.S.O. 1990, c. R.23.

3. Ontario Public Guardian and Trustee Releases Advice on Fundraising[73]

The OPGT released a bulletin in July 2009 entitled "Charitable Fundraising: Tips for Directors and Trustees" (the "Bulletin") that provides helpful information to directors and trustees of charities in Ontario on conducting charitable fundraising.[74] The Bulletin reminds directors and trustees of Ontario-based charitable organizations that a poorly conducted fundraising program not only damages the reputation of the individual charity, but also brings harm to the sector as a whole, as well as possibly exposing directors and trustees to personal liability. The Bulletin also reminds charities that they cannot conduct fundraising activities as a charitable purpose in their own right; charities must be open and transparent about their fundraising activities; costs are to be reasonable and accurately recorded; and directors and trustees in Ontario have a fiduciary duty with regard to their charitable assets, as well as being in compliance not only with the ITA, but also with the *Trustee Act*[75] (Ontario) and the regulations under the *Charities Accounting Act* (Ontario).

The Bulletin reinforces the notion that in order to be successful in a fundraising campaign, directors and trustees should carefully plan their campaign based on *defensible business decisions*. The OPGT recommends that directors and trustees prepare a budget and a written plan of action before embarking on a fundraising campaign. In setting out a written plan, directors and trustees are also encouraged to give special attention to the method they will select for their campaign, as some methods may be inappropriate given the image of the charity, while others may require a permit or license such as a charitable gaming event.[76]

While the Bulletin states that the disbursement quota under the ITA can be used as a guideline concerning what are reasonable fundraising costs, the Bulletin fails to mention that the new CRA Guidance on Fundraising is actually the better federal guideline that should be used by charities. The Bulletin goes on to explain that should charities in Ontario fail to keep proper accounts of

[73] For more information see Terrance S. Carter, "Ontario Public Guardian and Trustee Provides Tips on Charitable Fundraising" in *Charity Law Bulletin* No. 176 (September 29, 2009) online: http://www.carters.ca/pub/bulletin/charity/2009/chylb176.pdf.
[74] The full Bulletin can be found online at: http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/Bulletin-8.asp, posted in July 2009.
[75] R.S.O. 1990, c. T.23.
[76] *Supra* note 74 at 2.

their fundraising activities, the OPGT can ask that their accounts be passed before the court should the OPGT become concerned.[77]

Where a charity is considering the use of a commercial fundraiser, the Bulletin provides a useful appendix listing factors for charities to consider before signing a contract with a commercial fundraiser, which directors and trustees should review. The Bulletin explains that fundraising contracts that are unreasonable may be set aside by the courts and fundraising contract fees may be ordered to be repaid by either the directors or the fundraisers. The Bulletin indicates that the fundraising costs, combined with the charity's administrative costs, must be reasonable and the fact that the fundraiser is receiving a fee and its quantum should be disclosed. As well, the board of directors or trustees must not have an interest in the commercial fundraiser in order to avoid a conflict of interest.[78]

As well, the Bulletin points out that charities that fundraise for a special purpose must use those funds only for the stated purpose and must be keep them separate from the charity's operating funds. The Bulletin recommends that the charity should provide for an alternative purpose for the funds, and that such alternative purpose should be disclosed to potential donors.[79]

Lastly, organizations that are not charities registered under the *Income Tax Act* and do not have the ability to issue receipts must not make any misleading statements to the contrary in their solicitations. In addition, where the charity is not going to issue a receipt for amounts below a set minimum, this must also be clearly communicated to potential donors in their fundraising materials.[80]

Taken together with the recent CRA Guidance on Fundraising, the tips on fundraising contained in the Bulletin provided by the OPGT provide a useful resource for directors and trustees in Ontario to ensure their fundraising practices are done in accordance with both federal and provincial requirements. Directors and trustees can spare their charity significant headaches by

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[77] *Ibid*. at 3.
[78] *Ibid*.
[79] For more information on special purpose funds, reference should be made to Terrance S. Carter, "Donor-Restricted Charitable Gifts: A Practical Overview Revisited II" (2006) online: http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf.
[80] *Supra* note 74 at 4.

ensuring that their fundraising costs will not be subject to court review after investigation. It is not only poorly managed campaigns that can damage the reputation of the good work many do in the sector, but also regulatory crackdowns of a few bad charities that unfortunately can encourage the misconception that public funds are vulnerable to abuse by charities.

H. CONCLUDING COMMENTS

As can be seen from the above overview, the past 12 months have seen a significant number of changes with regard to the law of charity at both the federal and provincial level. The broad extent and number of changes that have occurred during the past 12 months underscore how complicated the law pertaining to charities has become in Canada. It is therefore important for estates and trusts practitioners who practice in this area to keep abreast of developments in the law as they occur.