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NEW CRA POLICY ON UMBRELLA ORGANIZATIONS

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A. INTRODUCTION

This *Charity Law Bulletin* ("Bulletin") provides a brief overview of the draft policy entitled *Guidelines for the Registration of Umbrella Organizations* that was released by Canada Revenue Agency ("CRA") on July 29, 2005 ("Guidelines"). The Guidelines discuss the eligibility of umbrella organizations for charitable registration and are available on CRA's website at http://www.cra-arc.gc.ca/tax/charities/consultations/umbrella-e.html.

B. WHAT IS AN UMBRELLA ORGANIZATION?

The term "umbrella organization" is often used interchangeably with terms such as "facilitator organization," "parent organization," or "intermediary organization." The Guidelines define a charitable umbrella organization as one that "works to achieve a charitable goal by supporting, improving, and enhancing the work of groups involved in the delivery of charitable programs."

The Guidelines make it clear that an umbrella organization can qualify for registration, as it is the position of CRA that an organization does not necessarily have to work directly with individual charitable beneficiaries in order to be viewed as advancing a charitable purpose and having charitable activities. Rather, the Guidelines make it clear that "umbrella organizations that, through their activities, improve and enhance the charitable

activities of other, generally community minded organizations, are also advancing a charitable purpose." CRA notes that the work of such umbrella organizations is charitable "in so far as it contributes to an improvement in the quality of service to the public, as well as increasing the level of service available to the public."

The Guidelines then sets out the three types of umbrella organizations considered to be charitable and the related issues arising in relation to each type. They are as follows:

1) charities established to improve the efficiency and effectiveness of other registered charities;
2) umbrella organizations that work with and through constituent groups that may or may not be registered charities in order to achieve a recognized charitable purpose; and
3) charities that may or may not be an umbrella organization but that hold property for other registered charities.

Each of these three types of umbrella organizations is discussed in more detail below. However, it is important to note the Guidelines' assertion that an organization's eligibility for registration is determined by its focus on beneficiaries, rather than its constituent members. Although these two categories may overlap, CRA makes clear that they do not view the categories as necessarily the same, and defined them in the Guidelines as follows:

- a "beneficiary" refers to those individuals or organizations that the umbrella organization's charitable programs are designed to ultimately benefit; whereas
- a "member" refers to an individual or organization that, generally through a formal process of recognition, is given a defined right to participate in an umbrella organization's sphere of activity.

C. TYPES OF UMBRELLA ORGANIZATIONS

1. Charities Established to Assist Other Registered Charities

It has long been recognized by CRA that organizations that support the charitable sector by promoting the efficiency and effectiveness of registered charities are charitable at law. This is because CRA views these types of umbrella organizations as charitable, as they are engaging in activities that either improve the efficiency of charities (e.g. by reducing the amount of charitable property contributed to operational costs and administration), thereby increasing the amount of resources available to carry out charitable programs or, alternatively, engaging in activities that improve the effectiveness of charities (e.g. by

providing advice, assistance or expertise) by increasing the capacity of charities to deliver programs and serve individual beneficiaries.

CRA further clarifies that the beneficiaries of the services of an umbrella organization must be predominantly other registered charities. Accordingly, in order for such an umbrella organization to qualify for charitable status, it must evidence that a minimum of ninety percent (90%) of the beneficiaries of its services are registered charities and that any incidental support by it to organizations that are not registered charities must not exceed ten percent (10%) numerically and in terms of devoted resources.

This ability for umbrella organizations to support non-qualified donees in limited circumstances is a major development for CRA, although it does make clear that such support of non-qualified donees is limited to non-profits with purposes that are focused on providing a benefit to the community at large and does not include for-profit organizations. Presumably, this issue will be clarified in the final version of the Guidelines.

In relation to what constitutes acceptable charitable purposes for these types of umbrella organizations, the Guidelines indicate that the objects must clearly reflect that the purpose of the organization is to improve the efficiency and effectiveness of other registered charities. As well, CRA also recommends that the umbrella organization precisely set out the means by which it intends to improve the efficiency and effectiveness of other registered charities.

However, the use of such wording "improve the efficiency and effectiveness of other registered charities" in the objects alone is not sufficient to cause an umbrella organization to be granted charitable status if, for example, the purported efficiency to be achieved by the organization resulted in a private benefit being bestowed on a non-charity or other individuals. As well, an umbrella organization cannot engage in purposes that are considered to be political by CRA in accordance with its policies.

In addition to the objects, it is very important for the prospective umbrella organization to demonstrate how its activities are logical means of accomplishing its charitable purposes and that the said activities are reasonably likely to result in the improvement of the efficiency and/or effectiveness of the other registered charities being served. A list of sample activities in this regard is provided by CRA in the

Guidelines, which include, but are not limited to, providing facilities at below market costs to registered charities, providing specialized administrative services and providing professional consulting services to charities. All of these activities would be found by CRA to be charitable if it is reasonably likely that they will result in an improvement to the effectiveness or efficiency of the organizations served.

The Guidelines make clear that an umbrella organization providing these types of services would report the direct costs of such services as charitable expenses on its annual information return (T3010A) filed with CRA. As well, the Guidelines state that where a beneficiary charity of the services of an umbrella organization pays for such services, the beneficiary charity is expected to categorize these payments on its T3010A each year and that these payments are not considered to be gifts to the umbrella organization.

2. Umbrella Organizations Advancing a Recognized Charitable Purpose

The second type of umbrella organization addressed in the Guidelines are those established to further a particular charitable purpose, i.e. other than assisting charities, which may convey benefits on constituent groups as ancillary to the achievement of that purpose. These types of umbrella organizations could include ones that are related to a specific issue or a particular area of health or other science that all member groups share a common interest in. Where these types of umbrella organizations are specifically designed to increase, enhance or improve services to charitable beneficiaries, then it is also acceptable for such umbrella organizations to increase the capacity and ability of member organizations as a secondary result of their work.

It is important that the beneficiaries of this type of umbrella organization's purposes and activities are the public at large or at least a segment thereof. Where such an organization is intended to primarily benefit its members through its purposes and activities, then whether or not those members are predominantly registered charities or objects of charity will be a key consideration in determining whether that organization will qualify for charitable status.

In order to be found to be charitable by CRA, the purposes of this type of umbrella organization must always be stated in relation to the charitable category that the organization is established to advance, e.g. to advance the knowledge and study of a particular field of study through the organization of conferences and other educational forums on topic of relevance to related member groups and the

public. However, objects that are stated to be, for example, to provide support to member groups or to coordinate their activities, will not be acceptable to CRA. As well, the provision of general assistance by an umbrella organization to its constituent groups will not be an acceptable purpose to CRA unless such constituent groups are all charities.

In relation to its activities, this type of umbrella organization must be able to demonstrate that its activities achieve or advance a charitable purpose, although it may incidentally complement or supplement the work of its constituent groups. CRA will assess whether the proposed activities achieve or advance the charitable purpose and this will be found to be the case where the activity can reasonably be shown to result in an increase in the quantity, quality or availability of a charitable service to the public. Examples of acceptable types of activities for these types of umbrella organizations are set out in the Guidelines and include, but are not limited to, coordinating services between member organizations to ensure services are delivered to a maximum number of beneficiaries, holding conferences and seminars on topics related to the charitable purposes to be achieved, conducting and publicizing research or collecting and distributing the research of member groups through publications, and providing information to the government, press and public on the sector and issues relating to its charitable purpose.

CRA will also assess the degree of private benefit being conferred on non-charitable beneficiaries. As indicated earlier, while CRA does not generally permit a charity to gift funds or otherwise make its resources available to entities that are not qualified donees, the Guidelines indicate that an organization will not be ineligible for registration as a charity where the private benefit provided is incidental to the achievement of the charitable purpose. Separate guidelines are set out by CRA regarding the determination of whether a benefit is incidental or not.

In relation to the treatment of expenses, the Guidelines state that umbrella organizations of this type may have a significant amount of expenses that could appear to be administrative but that it is necessary to examine the charitable purpose the organization is established for and if the activity in question achieves this purpose before such a characterization is made. If the answer to this analysis is yes, then the said activity can be classified as a charitable expenditure on the T3010A. As indicated above, where a beneficiary charity of the services of this type of umbrella organization pays for such services, the

beneficiary charity is expected to categorize these payments on its T3010A each year and these payments are not considered to be gifts to the umbrella organization.

3. Charities Established to Hold Title to Property

The third type of umbrella organization addressed in the Guidelines is registered charities that are separately established by existing charities for the purpose of holding title to property. As CRA points out, the establishment of separate title-holding entities may be done for a variety of legal, financial and operational reasons. These reasons may include ensuring the protection of the assets of a high-risk charity by moving them to a separate title-holding charity. CRA makes clear that where an organization is established to hold title to property on behalf of other registered charities, such an organization may be registered as an organization established to assist other charities, although it is not to be classified as an umbrella organization per se.

The recognition by CRA that organizations established to hold title can be charitable organizations, as opposed to charitable foundations, is an important development. This is because under an earlier CRA policy, it was only possible for title-holding entities to be registered as charities if they were foundations, not charitable organizations. This requirement by CRA for title-holding entities to be foundations caused significant difficulties, as it meant that they, as foundations, were prohibited from incurring debt in acquiring the properties in question. Now, with the ability for title-holding entities to be registered as charitable organizations, it is possible for these entities to incur debts in taking title to property, thereby increasing the availability of asset protection arrangements for the charitable sector.

The type of organization that is addressed in this section of the Guidelines is one which acts as a holding company for property "beneficially owned" by another related registered charity, as opposed to one that is merely a landlord organization that owns a facility which leases, rents or allows the use of the facility by generally unrelated registered charities. CRA indicates that this latter type of landlord organization likely falls more into the first type of umbrella organization, i.e. charities which are established to improve the efficiency and effectiveness of other charities.

However, CRA's characterization of title-holding entities as holding property that is "beneficially owned" by another related registered charity is cause for concern. This concept of "beneficial ownership" by the tenant charity suggests that the title-holding entity is merely a bare trustee for the

tenant charity (ie. holding property in trust at the absolute disposal and for the absolute benefit of the tenant charity), and not itself the beneficial owner of the property in question. Where a title-holding entity is only a bare trustee of the said property as opposed to being its beneficial owner, then the main purpose of setting up the title-holding entity, being asset protection of the land and buildings from the activities of the operating tenant charity, would be lost.

It may be that the concept of "beneficial ownership" has been inadvertently equated by CRA with the requirement that the property owned by a title-holding entity be held exclusively for use by one or more specified charities, which could be achieved through the charitable objects of the title-holding entity. However, this does not necessarily mean that the title-holding entity is holding the land beneficially, i.e. as a bare trustee, for the said named recipient registered charity. Rather, they are mutually exclusive concepts for a title-holding charity to review at the time of its initial establishment, i.e. which charity or charities are to be provided exclusive use of the land and buildings by the title-holding entity and whether the title-holding entity is to hold the land in its own name or as a bare trustee for the recipient charity. Clearly, this issue will need to be addressed further by CRA in the final version of the Guidelines.

The beneficiaries of this third type of umbrella organization must be one or more registered charities exclusively. Its formal purpose must be to provide a charitable service of benefit to the tenant charity and not merely to hold title to property, as this alone is not charitable at law. The activities of these title holding organizations can vary from merely title-holding entities to ones that provide a more comprehensive range of services, for example, property management services. As well, some organizations may also be involved in securing and developing additional properties to be used for charitable purposes.

Further, the land holding charity must show that it provides some benefit to the tenant charity, although it is not clear why since the provision of land, typically with a building, should be recognized as an inherent benefit to the tenant charity. Some examples of the type of benefits that CRA would find acceptable would include the landlord charity providing other goods and services, such as modifying facilities to accommodate handicapped individuals, or where the use of the title holding charity reduces costs to the tenant charity. However, CRA points out that as the property is being held for the benefit

of the tenant charity as a registered charity, this review of the proposed benefits is not to be an onerous one.

There is a brief mention by CRA in the Guidelines that one reason why a tenant charity has to be a registered charity is in order to ensure that the property will continue to able to maintain its exemption from municipal property taxation. In relation to this matter, where property owned by an exempt charitable organization is subsequently transferred to a title-holding entity, it is possible for the existing municipal property tax exemption to be lost as a result of the transfer if the title-holding entity is not considered to be an exempt organization. This is because there are only specific types of registered charities that are entitled to exemption from municipal property tax, eg. churches and other religious institutions, hospitals, etc. Accordingly, before any property transfers take place to title-holding entities, these potential municipal property tax matters should first be carefully reviewed with legal counsel.

The Guidelines then address the requirements of these title holding entities with regard to reporting expenses. CRA states that the disbursement quota requires that charities expend amounts by means of their own activities or as gifts to qualified donees. As CRA defines "to expend" to mean "to spend, to use up, or to consume an asset," CRA concludes that this implies that "something is transferred once and for all, a giving up of title."

As such, CRA takes the position that a mere permission to occupy the premises does not constitute an expenditure, nor does it constitute a gift to the tenant charity. However, if the provision of services to other charities is considered to be charitable for the first type of umbrella organization, i.e. charities established to assist other registered charities, there is no reason why the fair market value of the provision of the premises to the tenant charity should not also constitute a charitable expenditure for a title-holding charity. This issue will also need to be addressed further by CRA in the final form of the Guidelines. Otherwise, the title-holding entity may have difficulty in meeting its disbursement quota under the *Income Tax Act* (Canada).

In this regard, the Guidelines state that where a title holding charity is paying expenses related to the property or incurs expenses related to services performed for the tenant charity, it may treat these as expenditures on charitable programs. As well, in order to avoid disbursement quota problems in the

year following acquisition of a property, CRA suggests that the title-holding charity receive a property which is a gift either as a 10-year gift where the property comes from a non-charity or as a specified gift where it comes from an existing registered charity.

However, the Guidelines state that problems may arise where the landlord charity holds title to a property that is only partly used in charitable activities or where it is carrying on an unrelated business in connection with a number of investment properties. In some situations, the Guidelines states that there may be remedies available under the *Income Tax Act* (Canada) to deal with the disbursement quota problems of title-holding charities, such as permission from CRA to accumulate property, the application of a disbursement quota excess to meet a shortfall or an application to CRA to reduce the disbursement quota. That being said, it is made clear that these remedies are only to be used in exceptional situations and not as the means to resolve chronic disbursement quota problems of these sorts of organizations.

D. CONCLUDING COMMENTS

While the Guidelines are a constructive step forward in policy development by CRA as it relates to umbrella organizations, there are still a number of concerns that will need to be addressed by CRA in working through the final form of the Guidelines. These concerns include the need to recognize that charities holding title to property will need to do so beneficially in their own names, as opposed to doing so as bare trustees for other charities, as well as the need to recognize the fair market value of premises provided to tenant charities in calculating the charitable activities expenditures of title-holding charities in order to meet their disbursement quota. In the meantime, though, the initiative CRA has taken in its initial draft of the Guidelines is a positive development that will in the long run facilitate the establishment of umbrella organizations to assist other registered charities and the resulting protection of charitable assets.

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