

DOCUMENTING TRANSFERS OF FUNDS OUTSIDE CANADA

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A. INTRODUCTION

A registered Canadian charity can use its finances and other resources to carry out charitable activities both within Canada and overseas. However, there are occasions where a charity has neither the employees nor the volunteers to carry out a desired project. This *Charity Law Bulletin* ("Bulletin") addresses the capacity of a registered charity to carry on its charitable purposes through structured arrangements with other organizations that are not registered charities.

In this regard, a registered charity may choose to work through an intermediary, such as an agent or a contractor, or by working with others in the form of a co-operative partnership or a joint venture. Any of these arrangements will necessitate entering into a formal agreement; otherwise the charity risks losing its registered charitable status. This Bulletin highlights some of the advantages of each type of arrangement, as well as some of the risks involved.

With reference to the Canada Revenue Agency's ("CRA") guidelines set out in *Registered Charities Operating Outside Canada*¹, this Bulletin also discusses the structuring of arrangements with third parties, such as the specificities of a written agreement. A major requirement is a clear description of the activities for

¹ Canada Revenue Agency, online: <http://www.cra-arc.gc.ca/E/pub/tg/rc4106/README.html>.

which funds or other resources have been transferred, outlining the limits of the authority given to the third party to act for the Canadian charity or on its behalf.

B. CARRYING OUT CHARITABLE PURPOSES

The *Income Tax Act* (“ITA”)² permits a registered charity to carry out its charitable purposes, both inside and outside of Canada, in one of only two ways:

1. Gifts to Qualified Donees

A registered charity can make gifts to other organizations that are on the list of qualified donees as set out in the ITA. Qualified donees include other Canadian registered charities, registered Canadian athletic associations, certain corporations resident in Canada, Canadian municipalities, the United Nations and its agencies, certain universities outside Canada, a foreign charity that the Canadian government has made a gift to in the preceding twelve months, and the Canadian government or a province.³

2. Carrying on Its Own Charitable Activities

The carrying on of its own charitable activities requires a charity to be actively involved in programs and projects that are intended to achieve its charitable purposes. This can be done by the charity directly funding its own employees and/or volunteers in carrying out its programs. It is not permissible for a registered charity to carry out its charitable purposes by merely giving either monies or other resources to an organization that is not a qualified donee, regardless of whether the donee is inside or outside Canada.

However, where a registered charity does not have its own employees or volunteers to carry out a project, it can work with other organizations regardless of whether that organization is a Canadian registered charity. In order to comply with the ITA, the registered charity must use structured arrangements which allow it to retain direction and control over the program, as well as the resources that it contributes to the program.

² R.S.C. 1985, c. 1 (5th Supp.).

³ *Ibid.* at par. 110.1(1).

C. CARRYING ON CHARITABLE ACTIVITIES THROUGH INTERMEDIARIES AND WITH OTHERS

1. Overview of Options

There are two ways that a registered charity can work with other organizations to achieve its charitable purposes: (1) working through intermediaries, such as an agent or contractor; or (2) working jointly with others. These arrangements will require the registered charity and the other organization to enter into a formal agreement. It is also important for the registered charity to ensure that it complies with the terms of the agreement. Failure to do so could potentially constitute grounds for charitable deregistration.

2. Co-operative Partnership

Co-operative partnerships are used where a registered charity wishes to work alongside other organizations and with beneficiaries for the purpose of all the parties carrying out a specific project. The partner organizations do not have to be qualified donees under the ITA. Each organization would be a partner – equal or otherwise – in the establishment, implementation and conducting of the project. Provided that the registered charity is actively involved in one or more elements of the project (i.e. as opposed, for example, to merely contributing monies), it is considered to be carrying on its own charitable activities.

There are some downsides to such an arrangement, such as joint and several liability for all partners involved in the co-operative partnership. As well, there might be disbursement quota issues where the Canadian charity makes contributions to that portion of a project that is administrative as opposed to charitable, such as providing administrative services only.

3. Joint Venture

A registered charity and other organizations can pool together their resources to establish and operate a charitable program or project as a joint venture. The organizations participating in the joint venture with the charity do not have to be qualified donees under the ITA. For example, the registered charity could contribute 20 percent of the funding to build an orphanage in a foreign country, together with the four other related charities located in different countries that each contributes an additional 20 percent to the joint venture.

The registered charity will be considered to be carrying on its own activities if it is an active participant exercising a proportionate degree of control in the joint venture program. It can also evidence that its share of responsibility for long-term planning, day-to-day decision-making and financial commitments is proportionate to the level of financing that it contributes to the joint venture.

Generally, a joint venture management committee is required to establish, conduct and oversee the joint venture. For example, where the registered charity contributes 20 percent of the total monies and the committee is comprised of ten people, the registered charity should then have two of its own representatives as members of the joint venture management committee.

A joint venture arrangement allows a smaller charity to participate with other, sometimes larger, charities in a charitable project through the pooling of monies and resources. Provided that the smaller charity has proportionate input into all of the planning, decision-making and oversight of the project, its monies do not have to be segregated from those of the other joint venture participants (as is the case with agency relationships), but instead can be pooled together and used for the joint venture.

Where pooled monies from the joint venture are used to purchase real estate or other tangible assets, ownership of the said assets does not have to be retained by the Canadian registered charity. However, it is often the case that the joint venture committee required to be established under the joint venture is either never established, or, if it is initially established, then it is not properly maintained for the full term of the joint venture. Where this occurs, then the transfer of monies by the Canadian charity to the joint project may be found to be offside the requirements of the ITA, which could lead to loss of charitable status.

4. Agency Relationships

In an agency agreement, a registered charity appoints an agent to act as its representative in carrying out specific tasks on behalf of the charity, and in doing so, transfers some of its charitable monies to the agent on its behalf. Agents can be either organizations or individuals. As well, they do not need to be either qualified donees under the ITA or registered charities in their own countries. Provided that the registered charity in Canada retains direction and control over the tasks being carried out by the agent,

as well as the monies or other resources transferred to the agent, those tasks are considered to be the charitable activities of the registered charity itself.

Appropriate agency agreements are required to be entered into between the registered charity (known as the principal) and the agent setting out the terms of the relationship. Agency agreements can be one-time agreements or, alternatively, can be master agreements establishing a longer term relationship between the parties, which are then supplemented by letter agreements accompanying each transfer of monies to the agent pursuant to the terms of the master agreement.

Agency agreements are the most common method used by registered charities to carry on activities outside of Canada where it does not have its own employees and volunteers to do so. However, one of the practical difficulties with agency arrangements is that in order for the registered charity to retain control over the project or tasks being carried out by the agent, the monies or resources transferred to the agent need to be segregated from the funds of the agent. There are also strict reporting obligations by the agent to the registered charity.

In addition, there are liability concerns arising from an agency arrangement. That is, the actions of the agent are deemed to be actions of the principal. As a result, the principal is vicariously responsible for the actions of the agent. This vicarious responsibility for the acts of its agent can expose the registered charity (as principal) to significant liability, both civil and criminal (e.g. anti-terrorism legislation), for the actions of the agent. This concern is identified by the CRA in its guide entitled *Registered Charities Operating Outside Canada*.⁴

In relation to insurance matters, insurers for a charity may express concerns about the vicarious liability risks associated with agency relationships. The liability risk of a charity that is associated with any of its agency relationships may not be covered by the charity's insurance policy unless fully disclosed to the insurer and confirmed in writing. It is important for a charity to advise its insurer in writing of the nature and extent of its agency relationships to ensure there is proper insurance coverage for the agent's activities, particularly where they take place outside Canada.

⁴ *Supra* note 1.

There are also concerns involving financial statements arising from the utilization of agency arrangements. By appointing agents to carry out a registered charity's charitable work, the assets provided to the agents for the identified projects would continue to be assets of the registered charity and would need to be reflected in its financial statements. It is for this reason that CRA requires agents to segregate funds provided to the agent by the Canadian registered charity from the agent's own funds, and to keep separate books and records, among other requirements. However, in leaving these monies on the financial statements of the charity, it might result in a negative impact on future fundraising by the charity, as it could lead donors to believe that the charity has more funds available to it than it in fact has.

In relation to the registered charity's disbursement quota, it must comply with the normal requirement under the ITA to expend 80 percent of its receipted income in the previous year on charitable activities in the current year. In addition, it must expend 3.5 percent of its assets that are not used directly in its charitable activities or administration for taxation years that begin after the year 2008. Similar to the financial statement concerns, the assets provided by a registered charity to agents for the identified projects will not be considered to have been expended for the purpose of its disbursement quota until such time as they are actually spent on direct charitable work by the agent. Where there is a delay in the agent expending monies received from a registered charity, i.e. monies received in 2006 that are not expended until 2007, then such monies cannot be used to meet disbursement quota obligations that the registered charity may have for the 2006 fiscal year.

5. Contract for Service

A registered charity can also carry out its charitable activities by contracting with an organization or individual in another country to provide specific goods and/or services. Contractors can be organizations or individuals and do not need to be either qualified donees under the ITA or recognized charities in their own countries. For example, a Canadian registered charity with charitable purposes to advance religion may contract with organizations located outside Canada to conduct religious activities in designated countries in accordance with the terms of the contract.

The registered charity is required to give precise instructions to its contractors. This necessitates that a written contract be entered into between the parties which clearly sets out what the contractor is to do

in return from the payment being received from the charity and the reporting obligations that the contractor has back to the charity.

With regard to liability concerns, the vicarious liability that exists between a registered charity and its agent in an agency relationship does not generally exist with a contract for service between a registered charity and the third party organization with whom they contract to provide services. This is because the vehicle being utilized to effect the relationship is different, i.e. a contract versus a principal/agent relationship. Instead, any liability associated with the work being carried out by the third party contractor under the contract for service is generally limited to the said contractor under the contract and, therefore, should not extend back to the charity. However, it is open to a plaintiff in a lawsuit being brought against a third party contractor and the charity to argue that the charity exercised too much day-to-day control over the activities of the contractor and, therefore, has liability for the actions of the contractor.

With regard to financial statements, in a contract for service, the assets that are transferred to the third party organization in exchange for services are no longer the assets of the registered charity and therefore do not need to continue to be reflected in its financial statements.

With regard to the disbursement quota, similar to the financial statements, once assets have been transferred to third party contractors under a contract for service for goods or services that are an integral part of the registered charity's work, they are considered to have been expended for the purposes of the registered charity's disbursement quota. This is the case even where the third party organization has not expended the said monies itself within the applicable fiscal year of the registered charity.

With respect to insurance, in contrast to an agency relationship, a contract for service may be more attractive to the insurer. This is because a contract for service does not generally involve vicarious liability for the actions of the third party contractor as is the case with an agency relationship.

D. STRUCTURING OF ARRANGEMENTS WITH THIRD PARTIES

1. General Guidelines

By working with third parties using one of the above-referenced legal relationships, a registered charity can use its monies or other resources to carry out charitable activities both inside and outside of Canada. However, for these types of arrangements to be accepted by CRA as the registered charity's own activities, the following must take place as set out in CRA's Guide RC4106:⁵

- ◆ The charity must be reasonably assured that the organization or individuals can deliver the required services;
- ◆ All expenditures must be in accordance with the registered charity's own charitable purposes and will be used for the charitable activities of the registered charity itself;
- ◆ There is an appropriate agreement entered into by the parties setting out the terms of their relationship;
- ◆ The registered charity provides specific instructions to organizations or individuals, when required;
- ◆ The charity must regularly monitor the program or project and can provide appropriate evidence of the progress of the program or project to CRA when requested; and
- ◆ Periodic payments are made on the basis of its monitoring of the program or project's progress and the charity has the right to discontinue payments, if necessary.

2. Written Agreements

CRA's Guide RC4106⁶ indicates that written agreements with third parties, whether they are agents, contractors, joint venture participants or partners, would need to "typically include **at least** the following information:

- ◆ Names and addresses of all parties;
- ◆ The duration of the agreement or the deadline by which the project must be completed;
- ◆ A description of the **specific** activities for which funds or other resources have been transferred, in sufficient detail to outline clearly the limits of the authority given to the recipient [third party] to act for the Canadian charity or on its behalf;
- ◆ Provision for **written** progress reports from the third party of the Canadian charity's funds or other resources, or provision for the charity's right to inspect the project on reasonably short notice, or both;

⁵ *Ibid.*

⁶ *Ibid.*

- ◆ Provision that the Canadian charity will make payments by instalments based on confirmation of reasonable progress and that the resources provided to date have been applied to the specific activities outlined in the agreement;
- ◆ Provision for withdrawing or withholding funds or other resources at the Canadian charity's discretion;
- ◆ Provision for maintaining adequate records at the charity's address in Canada;
- ◆ In the case of agency agreements, provision for the Canadian charity's funds and property to be segregated from those of the agent and for the agent to keep separate books and records; and
- ◆ The signature of all parties, along with the date [of signing and effective date, where applicable].

E. CONCLUSION

Registered Canadian charities have the capacity to use their resources to undertake charitable activities overseas. If the charity cannot perform these activities on its own, it can use a structured arrangement with agents, contractors, or through a co-operative partnership or joint venture. These arrangements require a written agreement evidencing how the Canadian charity will retain control over the transferred monies and a full awareness of the liabilities which may arise. Charities should also be familiar with CRA guidelines and, in particular, those contained in *Registered Charities Operating Outside Canada*.⁷ As non-compliance with the requirements of the ITA and CRA regarding transfer of monies outside of Canada can potentially lead to loss of charitable status, charities need to proceed very carefully in this area.

⁷ *Ibid.*