

## APPLYING FOR FEDERAL INCORPORATION AND CHARITABLE STATUS

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### A. INTRODUCTION

This *Charity Law Bulletin* (“Bulletin”) provides a brief overview of the general steps that are required in order to incorporate a federal corporation under the *Canada Corporations Act* (“CCA”), and apply for registration as a “charitable organization” under paragraph 149.1(1) of the *Income Tax Act* (Canada) (“the ITA” or “the Act”). This Bulletin assumes that the charity will carry out its activities in the Province of Ontario, and therefore this Bulletin provides some commentary on a few of the more important issues relevant to charities operating in that province.

While Bill C-21, *An Act Respecting Not-for-profit Corporations and Other Corporations without Share Capital*, was earlier expected to have been passed by the federal government by the date of this Bulletin, the bill subsequently died on the Order Paper on November 29, 2005, following the dissolution of Parliament for the general election and the bill has not been re-introduced by the new Conservative federal government to date. Accordingly, this Bulletin will focus on the incorporation procedures to be undertaken pursuant to the current regime established by Industry Canada under the CCA. For information on expected changes under Bill C-21, reference can be made to *Charity Law Bulletin* No. 60 entitled “New Canada Not-For-Profit Corporations Act and Its Impact on Charitable and Non-Profit Corporations” dated December 30, 2004, available at [www.charitylaw.ca](http://www.charitylaw.ca). While charities operating across Canada will also need to consider other compliance issues, including, but not limited to, extra-provincial registrations, privacy, investment powers, and anti-terrorism legislation, those topics and other legal issues are beyond the scope of this Bulletin. This

Bulletin has been prepared using plain language as much as possible in order to facilitate consideration and understanding of the issues described in this Bulletin by those volunteers of charities who may not necessarily have any legal background. As such, footnotes to authorities are not included, although references to resource websites are provided where appropriate.

## B. INCORPORATION

### 1. Why consider incorporation?

There are several different legal forms through which a charity can be organized and carry out its activities, including an unincorporated association, a trust and a corporation. A brief commentary concerning the various options is provided below in order to facilitate an understanding of the benefits of incorporation.

Unlike a corporation, an unincorporated association is not a separate legal entity and has no legal status apart from its members. An unincorporated association is essentially a contractual agreement among a number of persons that establishes an organization to achieve the stated common purpose as reflected in the memorandum of association, constitution or other constating document, as the case may be. As a result, an unincorporated association exposes its members, in addition to its directors, to personal liability. Since an unincorporated association is unable to hold property in its own name, property needs to be held in the name of individuals acting as trustees for the unincorporated association. In addition, an unincorporated association is generally unable to sue, be sued, or enter into contracts on its own and would therefore require its members to do so in a representative capacity.

Trusts are created when one person or several people hold legal title to property, with beneficial ownership being held by another person or for charitable purposes. Trusts are usually established by trust documents or other instruments and are commonly used for estate, tax or charitable purposes. A trust arrangement requires the appointment of successive trustees and therefore does not have a permanent nature to it. Trustees can be exposed to a high degree of personal liability.

In contrast to an unincorporated association or a trust, a corporation is a separate legal entity independent of its members, officers, and directors. In this regard, a share capital corporation is utilized

to operate for-profit businesses whereby the corporation is owned by its shareholders and the purpose of the corporation is to generate profit.

A non-share capital corporation, however, is generally used for non-profit purposes whereby the corporation is not owned by anyone but is governed by the members, officers and directors of the corporation, and normally without the intent of making a profit. Incorporation results in the perpetual existence of a separate legal entity, in contrast to an unincorporated association or a trust arrangement where an organization would cease to exist when all of the members or trustees die or leave the organization. Unlike an unincorporated association a corporation can own property in its own right and can also bear liability for its own actions. A corporation can own, mortgage and lease land and all other assets in its own name without having to rely upon trustees or members to do so in a representative capacity on behalf of the corporation.

A corporation also provides the benefit of limited liability protection for its members, i.e. members of a corporation generally cannot be sued or held liable for the debts or liabilities of the corporation. While directors of an incorporated charity must still meet a high fiduciary standard of care and may be exposed to liability, the directors and the members of a a corporation can take steps to adopt a by-law that would authorize the corporation to indemnify its directors and officers for claims made against them by third parties.

Incorporation will involve an initial one time start up cost when undertaken with the assistance of legal counsel, although the expertise available through legal counsel can be an important benefit to the corporation in the long-term by assisting in the establishment of an appropriate documentary foundation that will suit the governance, operational and other needs of the corporation. In addition, legal counsel can also help to ensure that the necessary steps are taken to file appropriate annual corporate returns and notices whenever there is a change of directors, officers or head office. Minutes of the corporate meetings of the members and the directors will also need to be maintained on an on-going basis.

Incorporation of a non-share capital corporation can be achieved through either the provincial government, e.g. the Province of Ontario under the *Corporations Act* (Ontario), or through the federal government under the *Canada Corporations Act*, although this Bulletin focuses on the latter of the two options.

While organizations are not legally required to be incorporated before applying to become a registered charity, many registered charities do proceed with incorporation for the advantages outlined above.

2. Steps to be undertaken in order to incorporate as a federal corporation

In order to apply for incorporation under the CCA, it is necessary to submit the following documentation to Industry Canada:

- Two original signed copies of the application for incorporation. Once prepared, this document and any amendments reflected in supplementary letters patent that have been formally approved by Industry Canada, are collectively referred to as the “letters patent”;
- A statutory declaration of one of the applicants for incorporation that has been sworn before a lawyer or a commissioner for swearing oaths, stating that the contents of the application for incorporation are true, and addressing other issues required by Industry Canada;
- A cheque enclosing the \$200 filing fee;
- A Canada-based NUANS corporate name search report confirming the availability of the desired corporate name;
- An unsigned copy of the proposed general operating by-law for the corporation;
- A completed copy of the Not-for-profit Checklist confirming that the letters patent and the general operating by-law are in compliance with applicable Industry Canada’s requirements; and
- A brief covering letter specifying the full street address of the head office for the corporation.

Further explanation concerning the items that must be addressed in the letters patent and general operating by-law are provided below.

The letters patent are analogous to the birth certificate for a corporation, in that it sets out the date on which the corporation came into existence and also establish the corporate objects within which the organization can operate. Where a corporation intends to apply for status as a registered charity, the corporate objects contained in the letters patent must be charitable. In this regard, in order to qualify for registration as a charity with Canada Revenue Agency (“CRA”), both the corporate objects contained in the letters patent and the day-to-day activities carried out in furtherance of those objects must be

charitable in accordance with applicable Canadian law. To facilitate the drafting process, where possible, the objects can be prepared with reference to the applicable policy statements available on the CRA website at [http://www.cra-arc.gc.ca/tax/charities/policy/csp/csp\\_menu-e.html](http://www.cra-arc.gc.ca/tax/charities/policy/csp/csp_menu-e.html) and the pre-approved objects available on the website for the Office of the Public Guardian and Trustee of Ontario (“PGT”) at <http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/nfpinc/appendixg.asp> (which can also be helpful in drafting charitable objects for federal corporations). Additional comments concerning the requirements that must be met in order to qualify for charitable status in Canada are provided at section C of this Bulletin.

If the organization is a religious based charity and wishes to confirm the importance of its statement of faith or alternatively if a non-religious charity wishes to underscore the importance of its mission statement or philosophy of operations, those items may be included in the letters patent for the organization in order to assist in entrenching the importance of those guiding principles within the governing documents of the organization.

Other key items that need to be reflected in the letters patent for a charity include the head office location, as well as a dissolution clause stating that in the event of dissolution or winding up and after payment of all of its debts and liabilities, the corporation’s remaining property will be distributed to one or more charities in Canada that are registered as such under the ITA. Generally, it is recommended that the recipient charities be restricted to those that have similar objects to those of the applicable charity. Once the letters patent has been drafted, it must be signed by a minimum of three individuals who will serve as the first directors of the corporation. The complete names of the three individuals (including middle names), as well as their home addresses and occupations should also be inserted.

The general operating by-law usually sets out the governance structure and key internal operational procedures for the corporation. The by-law must be enclosed with the application for incorporation and needs to be prepared in accordance with the provisions applicable to non-share capital corporations set out in the CCA, as supplemented by the Not-for-profit Policy Summary available on the Industry Canada website. The key items that need to be included in the general operating by-law include: qualification requirements and procedures that apply to admission of members; identification of the class(es) of membership and corresponding voting rights; notice requirements and quorum requirements that apply to meetings of members; qualification requirements and procedures that apply to election of

directors; notice requirements, voting rights and quorum requirements that apply to meetings of directors; processes through which directors may be removed, as well as other standard corporate matters such as the fiscal year end for the corporation, signing authority on behalf of the corporation and related governance and procedural issues. For further information on the mandatory items that must be reflected in general operating by-laws for federal corporations, reference can be made to both the Policy Summary, which is available at <http://strategis.ic.gc.ca/epic/internet/incd-dgc.nsf/en/cs00011e.html>, and the Corporations Canada Model By-law: Not-for-profit, which is available at <http://strategis.ic.gc.ca/epic/internet/incd-dgc.nsf/en/cs00014e.html>.

Once the application for incorporation has been filed with Industry Canada, the time required to process the application can range between three to four weeks, subject to the processing times in effect at Industry Canada. However, once the letters patent has been issued, the date of incorporation will be the date on which Industry Canada originally received the incorporation application.

When incorporation has occurred through the formal issuance of letters patent by Industry Canada, it is necessary to confirm the structure of the corporation through the adoption of initial organizing resolutions which will confirm the first directors and members, adopt the by-laws, approve the banking resolution as well as address other standard corporate matters which need to be approved at the first meetings of the directors and members, respectively, and which resolutions should be signed by the relevant parties to confirm those matters have been completed. The corporation will also need to complete other miscellaneous filings and corporate matters including registration as an extra provincial corporation in Ontario by the filing of Form 2 – Initial Return/Notice of Change with the Ministry of Government Services (“MGS”), as well as ordering the corporate seal and minute book for the Corporation.

Although a corporation may use names other than its corporate name in representations to the public, all operating business names must first be registered with the MGS pursuant to the *Business Names Act* (Ontario). Accordingly, the need for a business name registration with the MGS should also be reviewed.

## C. CHARITABLE STATUS

### 1. Charitable status vs. non-profit status

As indicated earlier in this Bulletin, there are no shareholders who “own” the corporation in non-share capital corporations because the purpose of the corporation is not to earn money but is instead to fulfil its non-profit or charitable objectives. A non-share capital corporation is governed by the members, officers and directors of the corporation. A non-profit corporation can either be a not-for-profit organization or a corporation that has status as a registered charity. As there is widespread misunderstanding concerning the difference between a “non-profit organization” (“NPO”) and a “charitable organization,” a brief explanation concerning the differences between tax status as an NPO or a charity are provided below.

Under the provisions of the ITA, an NPO is an association organized and operated exclusively for any combination of the following purposes: social welfare; civic improvement; pleasure or recreation; or any other purpose except profit. In order to qualify as an NPO under the relevant provisions of the ITA, an association must be both structured and operated exclusively for any combination of the above purposes. Examples of NPOs, i.e. organizations that are not charities are sports clubs, service clubs, non-profit housing corporations and trade associations. NPOs are generally exempt from the payment of income tax both at the federal and provincial levels, although other tax issues may require further consideration.

For an organization to be registered as a charity, its purposes have to fall within one or more of the following general categories of charitable purposes as identified by the courts: the relief of poverty; the advancement of education; the advancement of religion; or other purposes beneficial to the community in a way that the law regards as charitable. There are two basic tax related advantages of being a registered charity. Charitable registration results in exemption from the requirement to pay income tax and additionally allows an organization to issue official receipts for gifts received. This reduces the individual donor’s income tax payable or the taxable income of a corporate donor. However, in the Province of Ontario, directors of charitable organizations must not receive any direct or indirect remuneration from the charity, although they can be reimbursed for reasonable out-of-pocket expenses incurred on behalf of the charity. This prohibition on receipt of direct or indirect remuneration by a

director does not apply to directors of NPOs and generally only applies to charities operating in Ontario.

Under the provisions of the ITA, there are three types of designations for registered charities: charitable organizations, public foundations and private foundations. The designation of a charity as either a charitable organization, a public foundation or a private foundation depends on its board composition, its source of funding and the charity's activities. At present, in order to qualify as a charitable organization, less than 50% of a corporation's directors can be related persons and at least 50% of the funds it receives can be from donors who are not related persons.

However, on July 18, 2005, the Department of Finance released legislative proposals to amend the ITA ("July 2005 Amendments") that consist of a package of changes to consolidate and further amend previously proposed amendments introduced in 2002, 2003 and 2004. New definitions of charitable organizations and public foundations in the July 2005 Amendments will replace the current contribution test (requiring that not more than 50% of the capital contributed to a charitable organization or public foundation be from one donor) with a control test. The new control test will allow a donor to donate more than 50% of the capital of a charity, provided the donor or donor group does not exercise control directly or indirectly in any manner over the charity and is not in a non-arm's length relationship with more than 50% or more of the directors or trustees of the charity. This new regime once adopted into legislation will be retroactive to 2000. Since organizations that wish to carry on its own charitable activities would generally require status as a "charitable organization," this Bulletin focuses on this type of charitable designation. Organizations designated as public and private foundations do not generally carry out their own charitable programs, but instead focus on either soliciting and/or managing funds in order to distribute them to other registered charities.

To maintain charitable status, charities must comply with the requirements of the ITA, which include, but are not limited to the following:

- It must devote its resources to charitable purposes;
- It must not pay, or otherwise make available, its income to any of its members (it can however pay reasonable salaries or reimburse reasonable out-of-pocket expenses);



- When issuing official donation receipts it must do so in accordance with the ITA and the *Income Tax Regulations*;
- It must keep proper books and records, and provide these and other relevant information to CRA as required by the Act;
- It must file the Registered Charity Information Return (Form T3010A), within six months of the charity's fiscal year-end; and
- It must otherwise continually meet the other requirements of its charitable registration, including but not limited to restrictions on business and political activities.

2. Steps to be undertaken in order to apply for status as a registered charity

In order to apply for charitable status, it is necessary to submit the following documentation to CRA:

- a completed Application to Register a Charity Under the ITA, (Form T-2050 E (01)) that has been signed by two directors or officers of the applicant organization;
- a copy of the letters patent and supplementary letters patent, if any, that have been certified by two directors or officers; and
- a copy of all by-laws for the applicant organization that has been certified by two directors or officers.

There is no filing fee payable in order to submit an application for charitable status with CRA.

While most of the Form T2050 is relatively straightforward, there are several portions of the form that merit careful attention. In order to complete Part 5 – Financial Information on the Form T2050, the applicant organization needs to prepare a proposed first year budget that sets out the expected sources of income, e.g. income from individual donors, businesses, government grants, fundraising, and outline the intended expenditures. Since it is difficult to precisely determine anticipated income streams and expenditures, it is generally understood that the proposed budget developed for the first year of the applicant organization's operations is intended to reflect best estimates in this regard. In reviewing the financial information outlined in Part 5, CRA will consider whether or not at least of 80% of the total of

received income, i.e. income for which a charitable donation receipt has been issued, will generally be expended on charitable activities in compliance with CRA requirements.

A detailed statement of activities, describing the day-to-day programs to be carried out in furtherance of the objects contained in the letters patent also needs to be enclosed with the Form T2050. As indicated above, in order to qualify for registration as a charity with CRA, both the objects contained in the letters patent and the actual activities carried out in furtherance of those objectives must be considered by CRA to be charitable in accordance with applicable Canadian law, although whether an activity is charitable or not is in fact a function of the object that it is intended to achieve. The statement of activities must reflect a detailed description of how the objects will be achieved by illustrating the specific types of programs to be undertaken. For example, a charitable object that reflects the goal of alleviating poverty could have as an activity the operation of a weekly soup kitchen or daily food banks in order to assist low-income individuals in furtherance of that object.

Information concerning the applicant organization's assets and liabilities, as well as general information regarding anticipated fundraising activities to be carried on by the corporation also need to be described in the Form T2050.

Subject to the current processing times in effect at CRA, once an application for charitable status has been filed, confirmation of receipt of charitable status can range between four to six months for straightforward applicants, such as churches, synagogues, mosques and public foundations, or six to nine months or longer for unique applicants. Further time may also be required to address any additional questions posed by CRA on the application. However, once charitable status has been confirmed by CRA, the effective date of the charitable status could be either the later of (i) the first day of the calendar year in which CRA received the application for charitable status or (ii) the actual date on which CRA received the said application, as determined in CRA's discretion. If a charity receives charitable status in any given year, it can issue charitable donation receipts for cash gifts received earlier in that year, although this retroactive ability to issue receipts does not apply to gifts of property received earlier in the year.

Where a charity plans to carry on activities outside of Canada or send monies outside of Canada in order to further its charitable purposes, the applicant organization will need to provide information in

the Form T2050 concerning the location where the disbursements will be made and the value of monies or property involved. When the charity begins carrying on its charitable activities outside Canada through a third party, it must put in place a formal agreement with the intermediary, e.g. an agency, joint venture, partnership or other contractual arrangement as the case may be, through which the charity can demonstrate that it retains direction and control over the use of its resources in accordance with the requirements reflected in the CRA publication entitled “Registered Charities: Operating Outside Canada”, RC4106(E). In reviewing the applicant organization’s application for charitable status, CRA may sometimes request a copy of a sample agreement that evidences the charity’s intentions in this regard. Employees, volunteers, or other representatives carrying on charitable activities outside of Canada under the direct control of the charity do not require a formal agreement to act on behalf of the charity overseas.

Finally, once charitable status has been confirmed by CRA, a copy of the letters patent and related governing documents must be provided to the PGT for their information and records.

#### D. OTHER CONSIDERATIONS

It is also important that charities establish on-going legal risk management procedures in order to identify areas of risk and remedial steps that may need to be taken. The “Legal Risk Management Checklist” for charities and Not-for-profits (condensed version),” dated January 31, 2005, available at <http://www.carters.ca/checklst.html>, contains helpful general guidelines. In this regard, the checklist provides an overview of the legal risk management issues that should be considered and addressed. For further resource materials on risk management issues, reference can also be made to Risk Protection, an excerpt from Primer for Directors of Not-for-Profit Corporations that was published by Industry Canada in 2002, which is available at the following internet address: <http://www.carters.ca/pub/book/2002/dirprimch6.pdf>.



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