

CARRYING ON CHARITABLE ACTIVITIES OUTSIDE OF CANADA THROUGH THE USE OF AGENTS AND CONTRACTORS FOR SERVICE

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A. INTRODUCTION

In general, Canadian registered charities can operate outside Canada in the same manner that they operate in Canada. That being said, Canadian registered charities that carry on programs and activities outside of Canada need to be aware that there are specific requirements imposed on them under the *Income Tax Act* (Canada) and by the Charities Directorate of the Canada Revenue Agency (“CRA”), as well as other legal issues that need to be addressed. However, since a review of all of the issues that should be considered by a Canadian registered charity operating outside of Canada is beyond the scope of this Bulletin, readers are encouraged to consult the Canada Revenue Agency’s guide, *Registered Charities: Operating Outside Canada* RC4106 (“CRA Guide RC4106”), for more information.¹

This Bulletin specifically focuses on the types of arrangements that a registered charity can utilize in order to conduct its charitable activities outside of Canada. In the past, the most common form of arrangement by which a charity carried on its charitable activities through intermediaries was the agency relationship. However, the agency relationship has always been subject to a number of limitations. Recently, the contract for service arrangement has become a viable alternative for Canadian charities to consider when carrying on charitable activities, both inside and outside Canada, through third parties. This Bulletin compares and

¹ Available online at <http://www.cra-arc.gc.ca/E/pub/tg/rc4106/README.html>.

contrasts the agency relationship with the contract for service arrangement, and reviews their respective advantages and disadvantages for charities that wish to further their charitable purposes outside of Canada.

B. CARRYING ON CHARITABLE PURPOSES OUTSIDE CANADA

CRA, in its CRA Guide RC4106, indicates that a registered charity can carry out its charitable purpose outside Canada in only two ways. First, it can make gifts to other organizations that are on the list of qualified donees set out in the *Income Tax Act*. “Qualified donees” are:

- ◆ registered charities;
- ◆ registered Canadian amateur athletic associations;
- ◆ registered national arts service organizations;
- ◆ certain housing corporations resident in Canada that are constituted exclusively to provide low-cost accommodation for the elderly;
- ◆ Canadian municipalities;
- ◆ the United Nations or its agencies;
- ◆ prescribed universities outside Canada (listed in Schedule VIII of the Act);
- ◆ charitable organizations outside Canada to which Her Majesty in right of Canada (the federal government or its agents) has made a gift during the taxpayer's taxation year or the 12 months before it; or
- ◆ Her Majesty in right of Canada or in right of a province (i.e., the federal government, a provincial government, or their agents).

Second, the charity can “carry on its own charitable activities” outside of Canada. According to the CRA, this “implies” that the charity must be “an active and controlling participant in a program or project that directly achieves a charitable purpose.”

That being said, the CRA recognizes that it “may not be practical for the charity to meet its ‘own activities’ test by operating abroad using its own employees or volunteers directly funded by that charity.” Therefore, the CRA makes it clear that it is permissible for a Canadian charity to “work with or through other organizations providing it employs certain structured arrangements that allow it to retain direction and control over the use of its resources.” Specifically, the CRA indicates that “a registered charity can carry on its charitable activities through intermediaries such as an agent, a contractor, or any other body”, for example joint venture or partnership arrangements. However, the provision of funding and support to non-Canadian registered charities is subject to specific requirements, including documenting such support by way of a

written agreement, which may take various forms, such as an agency relationship, contract for service relationship, joint venture, partnership, etc.

In this regard, whichever arrangement a Canadian charity utilizes in order to carry out its charitable purposes outside of Canada, the CRA requires that the following conditions be met in order for such an arrangement to be considered an acceptable devotion of the charity's resources to its "own activities":

- ◆ the charity has obtained reasonable assurance before entering into agreements with individuals or other organizations that they are able to deliver the services required by the charity (by virtue of their reputation, expertise, years of experience, etc.);
- ◆ all expenditures will further the Canadian charity's formal purposes and constitute charitable activities that the Canadian charity carries on itself;
- ◆ an adequate agreement is in place (the CRA recommends a written agreement containing the minimum elements outlined above);
- ◆ the charity provides periodic, specific instructions to individuals or organizations as and when appropriate;
- ◆ the charity regularly monitors the progress of the project or program and can provide satisfactory evidence of this to the CRA; and,
- ◆ where appropriate, the charity makes periodic payments on the basis of this monitoring (as opposed to a single lump sum payment) and maintains the right to discontinue payments at any time if it is not satisfied.

The CRA also requires a registered charity to ensure that its resources are devoted to charitable purposes. On this issue, the CRA Guide 4106 states the following:

“Therefore, where resources the charity is proposing to send outside Canada are of a general nature and could be used in a wide variety of non-charitable ways (money, for example, could be used for many things, while medicines, such as insulin, are only likely to be used to treat patients), the charity must be particularly careful to retain sufficient control to satisfy the requirements of the law.”

As indicated earlier, agency relationships have been the most common vehicle utilized by Canadian registered charities carrying on charitable activities, although they have been subject to various limitations. In light of these limitations, more Canadian registered charities are considering contract for service arrangements for carrying on charitable activities, both inside and outside Canada, through third parties. The next section of this Bulletin compares and contrasts, in generic terms, agency relationships with contracts for service that could be utilized by a charity when dealing with third party non-qualified donees.

C. AGENCY RELATIONSHIPS VERSUS CONTRACTS FOR SERVICES

1. General Description of Agency Relationship

In an agency relationship, a charity retains one or more third party organizations to act as its agent(s) in carrying out the work associated with a particular charitable project in accordance with the written instructions of the charity. An appropriate agency agreement would need to be entered into by the parties and, according to the CRA's Guide RC4106, should contain the following information:

- the names of the parties;
- the duration of the agreement or the deadline by which the project should 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 agent to act for the charity or on its behalf;
- the provision that the charity will make payments by installments based on confirmation of reasonable progress and that the resources provided to date have been applied to the specific activities outlined in the agreement;
- the provision to maintain adequate records at the charity's address in Canada;
- the provision for written progress reports from the agent to the charity on the use of monies, or provision for the charity's right to inspect the project on reasonably short notice, or both;
- the 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;
- the provision for withdrawing or withholding funds or other resources at the Canadian charity's discretion; and
- the provision for the charity to control and monitor all activities of the agent.

While not a requirement of CRA *per se*, the agency agreement will normally also contain a provision by which the agent agrees to indemnify the Canadian charity from any liabilities arising from the performance of its obligations under the agreement.

In addition to the "minimum provisions" required by the CRA, agency agreements should also generally contain provisions by which, among other things, the agent agrees to:

- comply with anti-terrorism legislation (both in Canada and in other jurisdictions in which the agent operates);
- submit to a specified conflict resolution mechanism in the event of a dispute or controversy;
- consent to the collection, use and disclosure of personal information about the agent as may be required;

- protect the personal information of other organizations and individuals which is collected, used, or disclosed by the Charity and which the agent may become aware of;
- protect any confidential information about the Canadian charity that the agent may become aware of; and,
- specific consequences in the event of any termination of the agreement.

Then, where there are a number of payments for a particular project, the Canadian charity could forward such monies by a separate written designation setting out how the monies are to be used by the agent. This separate designation would need to reference and supplement the main agency agreement.

2. General Description of Contracts for Services

It is also permissible for a charity to carry on its charitable activities through a contractor, or entering into joint venture or partnership arrangement with another entity. However, operating a project with another entity through a joint venture or partnership arrangement will generally expose the Canadian charity to liabilities that may arise from the joint venture or partnership.² Given these liability concerns, which are similar to those associated with an agency relationship, Canadian charities may want to consider carrying on charitable activities with a third party organization by means of a contract for service.

Under a contract for service, a registered charity contracts with an organization or individual in another country to provide needed goods and/or services in order to fulfill its charitable programs. Some examples of a contract for service that may be entered into by a Canadian charity with various organizations and individuals are provided by the CRA in its Guide RC4106 and are set out below:

“Before providing irrigation equipment for an agricultural project, a Canadian registered charity:

- commissions a soil analysis from a local university;
- contracts with a for-profit business in the country to deliver, install, and maintain the equipment; and
- contracts with a government agency to provide instructional or other services required to make the project a success.”

In the above example, the local university, the for-profit business, and the government agency would all be contractors for services on behalf of the Canadian charity in relation to carrying out its specific charitable project.

² For more information about these types of relationships, see CRA’s Guide RC4106 at pages 5-6.

A contract for service between a charity and a third party would need to be documented by a written agreement containing the same provisions discussed above in the context of a written agency agreement. In this regard, the CRA includes the following caution in its Guide RC4106:

“If a Canadian charity operates outside the country without a written agreement in the suggested form, it will probably have serious difficulty establishing that a project is charitable and that it is carrying on its own activities. This could jeopardize the charity's registered status under the *Income Tax Act*.”

3. How Contracts for Service Differ from Agency Relationships

The following is a summary of the main factors that differentiate a contract for service relationship from an agency relationship.

a) Liability

The vicarious liability that exists between a charity and its agent in an agency relationship does not generally exist with a contract for service between a charity and the third party organization with whom it contracts to provide services. This is because the vehicle being utilized to effect the relationship is different (i.e. a contract as opposed to a principal-agent relationship). As such, 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, is not generally transferable to the charity. That being said, it is important to be aware that it is always open to a plaintiff in a lawsuit being brought against a third party contractor and the charity to argue that the charity had too much day to day control over the activities of the contractor and, therefore, was liable for the said activities based upon a *de facto* agency relationship.

b) Financial statement

In a contract for service, the assets that are provided to the third party organization in exchange for services do not continue to be assets of the Canadian charity and do not need to be reflected in its financial statements. By contrast, where a Canadian charity appoints an agent to carry out its charitable work, the assets provided to the agent for the identified projects would continue to be assets of the Canadian charity and would need to be reflected in its financial statements. It is for this reason that CRA indicates in CRA's Guide RC4106 that agents are required to segregate funds provided to the agent by the Canadian registered charity from the agent's own funds, to keep separate books and records, to provide written progress reports to the charity, among other

requirements. However, in leaving these monies on the Canadian charity's financial statements, it might result in a negative impact on future fundraising by the said charity because it might lead donors to believe that the charity has more funds available to it than is, in fact, the case.

c) Disbursement quota concern

Similar to the financial statements, once assets have been transferred to a third party organization under a contract for service for goods or services that are an integral part of the charity's work, they are considered to have been expended for the purposes of the charity's disbursement quota purposes. This is the case even where the third party organization has not expended the said monies itself within the applicable fiscal year of the Canadian charity. By contrast, with an agency relationship, the assets provided by the Canadian charity to agents for the identified projects will not be considered to have been expended for the purpose of the Canadian charity's disbursement quota until such time as they are actually spent on direct charitable work by the agent. Where there is a delay in the said agent expending the said monies, i.e. monies received in 2007 are not expended until 2008, then such monies cannot be used to meet any disbursement quota obligations that the Canadian charity may have for the 2007 fiscal year.

d) Insurance Concerns

Some insurance companies and/or brokers may prefer the use of the contract for services by charities which are utilizing third party organizations to carry out their charitable activities. This is because, in addition to the liability concerns outlined above, insurance companies understandably may have misgivings about the vicarious liability risks associated with agency relationships and, as a result, may prefer that projects be undertaken through a contract for service arrangement. In this regard, the liability risk of a charity arising out of its agency relationships may not necessarily be covered by the charity's insurance policy. It is therefore important for a charity to advise its insurer in writing concerning the nature and extent of its agency relationships to ensure there is full insurance coverage in place for the agent's activities and that written confirmation of the same is received back from the insurance company.

e) No Need to Segregate Monies Received

Under an agency arrangement, the agent is required to keep the funds received from the Foundation segregated from the agent's own monies. Such a requirement, though, is not in place in a contract

for service agreement. However, it is still necessary that the contractor be able to provide receipts to the charity evidencing how it has spent the monies received for charitable programs and activities on behalf of the charity. Where it is impractical for receipts to be provided directly to the charity, then it would likely be satisfactory for the written contract for service to require the contractor to, at a minimum, have the supporting receipts available for review by the charity from time to time.

D. CONCLUSION

Charities that operate outside of Canada should carefully consider how they structure their arrangements with intermediaries who assist the charity in carrying out its charitable activities in other countries.

Although each charity's situation is different and should be assessed individually on its own facts and merits, there are generally a number of advantages that may arise in utilizing the contract for service arrangement, as discussed above. Whichever arrangement the charity decides to employ, it should have a clear idea of the charitable program it is trying to achieve and how it will be conducted from beginning to end. As observed by the CRA in its Guide RC4106, such foresight will allow the charity to give precise instructions to its agents or contractors and ensure that it remains onside of the requirements to carry on activities outside of Canada as set out in the *Income Tax Act* (Canada) and prescribed by CRA.