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UPDATE ON UMBRELLA ORGANIZATIONS AND TITLE HOLDING ORGANIZATIONS: FINAL VERSION OF CRA'S POLICY RECENTLY RELEASED

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A. INTRODUCTION

On May 6, 2008, Canada Revenue Agency ("CRA") released a new policy statement entitled "Guidelines for the Registration of Umbrella Organizations and Title Holding Organizations"[1] ("Guidelines"). The Guidelines replace CRA's earlier policy statements on similar issues, namely CPS-008[2] and CPS-009[3], in their entirety.

These guidelines were first proposed by CRA in 2005 in the form of a consultation paper entitled "Consultation on Proposed Guidelines for the Registration of Umbrella Organization"[4] ("Proposed Guidelines"). CRA solicited comments on the Proposed Guidelines from charities and individuals involved in charitable work up to October 31, 2005. An earlier *Charity Law Bulletin*, being No. 78 dated October 12, 2005, contained an overview of the provisions in the Proposed Guidelines, and raised some concerns about certain provisions in the Proposed Guidelines. [5]

[1] Canada Revenue Agency, *Guidelines for the Registration of Umbrella Organizations and Title Holding Organizations, CSP-026* (May 6, 2008), available online at: http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-026-e.html
[2] Canada Revenue Agency, *Organizations Established to Assist Other Charities CPS-008* (January 12, 1996).
[3] Canada Revenue Agency, *Holding of Property for Charities CPS – 009* (March 12, 1996, Revised January 14, 2003)
[4] Canada Revenue Agency, Consultation on Proposed Guidelines for the Registration of Umbrella Organizations (July 29, 2005).
[5] Terrance S. Carter and Jacqueline M. Connor, "New CRA Policy on Umbrella Organizations", *Charity Law Bulletin No. 78* (October 12, 2005), available online at: http://www.carters.ca/pub/bulletin/charity/2005/chylb78.pdf

While the comments received from the charitable sector about the Proposed Guidelines presumably resulted in some minor amendments being made, the substance of the Guidelines remains largely the same as the earlier Proposed Guidelines. The purpose of this *Charity Law Bulletin* is to provide a brief summary of the Guidelines, with a particular focus on highlighting any differences between the Guidelines and the Proposed Guidelines, as well as identifying some ongoing areas of concern in the Guidelines for umbrella organizations and title-holding entities.

B. CRA'S OVERVIEW OF THE PURPOSE OF THE GUIDELINES

The Guidelines are intended to clarify certain portions of subsection 149.1(1) of the *Income Tax Act* (Canada) ("Act")[6], which sets out the basic framework for the registration of an organization as a charity. Specifically, CRA identifies the following part of this subsection as being most relevant in relation to the Guidelines:

> …"charitable" organization means an organization, whether or not incorporated, (a) all of the resources of which are devoted to **charitable activities carried on by the organization itself**."[7]

Generally, in order to be registered as a charity under this subsection of the *Act* an organization must show that its activities are charitable in the sense understood by law and that those said activities are carried on by the organization itself. However, in the Guidelines, CRA makes clear that "an organization does not have to work directly with individual charitable beneficiaries in order to be considered to be advancing a charitable purpose"[8]. Rather, it is indicated that CRA "accepts that Umbrella Organizations can advance a charitable purpose by directing their activities at improving and enhancing the charitable activities of other generally community-level organizations"[9]. The activities being carried out by umbrella organizations are viewed by CRA as being "charitable in so far as [they] contribute to an improvement in the quality of service to the public, as well as increasing the level of service available to the public."[10]

CRA does make it clear that, while the Guidelines anticipate arrangements will be established whereby a registered charity may work with and through non-charitable entities, registered charities are still prohibited

[6] *Income Tax Act*, R.S.C. 1985 (5th Supp.), c.1, s. 149.1(1)
[7] *Ibid.*
[8] *Supra*, note 1.
[9] *Ibid*.
[10] *Ibid*.

from making gifts of their charitable property to non-qualified donees, as well as operating or using their resources for the private benefit of non-qualified donees.

C. DEFINITIONS

In the Guidelines, "a charitable umbrella organization" is defined by CRA to be "one that works to achieve a charitable goal by supporting, improving and enhancing the work of groups involved in the delivery of charitable programs", with the said groups being the ones, usually at the local level, who work directly with individual charitable beneficiaries. CRA distinguishes in the Guidelines between these types of charitable umbrella organizations, i.e. ones working with several charities, and those entities whose activities are predominantly "…intended to benefit or complement a **single** organization's work". These latter entities are not viewed by CRA as being umbrella organizations, although it is recognized that they may still qualify for registration as charities, provided that they are not merely created to simply circumvent restrictions imposed on the use of charitable resources, such as fundraising.

The Guidelines then review the distinctions between beneficiaries versus members as CRA indicates that "an organization's eligibility for charitable registration is determined by reference to its beneficiaries rather than its constituent members". For the purposes of the Guidelines, beneficiaries are intended to refer to "those individuals or organizations that the Umbrella Organization's charitable programs are designed to ultimately benefit", while members are viewed as being those individuals or organizations that are given "a defined right to participate in an Umbrella Organization's sphere of activity".

CRA then reviewed the distinctions that it sees between the two different types of umbrella organizations. The first type of charity is established to assist other registered charities, while the second type is an umbrella organization that itself advances recognized charitable purposes. This is a new section of the Guidelines, which was not included in the earlier Proposed Guidelines.

In relation to the first type, charities established to assist other registered charities, CRA describes them as those organizations that "restrict their beneficiaries to other registered charities" and "target its activities to improving the services of other registered charities".[11] Through such work, these types of umbrella

[11] *Supra*, note 1.

organizations improve most aspects of their beneficiary groups, i.e. other registered charities, such as direct delivery of charitable programs, planned giving campaigns, etc.

By contrast, the second type of umbrella organization is that which CRA describes as working "though a network of registered charities and non-registered entities to achieve a recognized charitable purpose".[12] However, given the involvement of non-registered charities in their work, CRA cautions that these types of umbrella organization must "restrict their work with non-charitable entities to the provision of services that are narrowly focused on increasing, enhancing, or improving the non-charitable entities services to charitable beneficiaries (i.e. the public)".[13] In addition, this type of umbrella organization must take steps to ensure that their activities do not confer any more than an incidental benefit on non-charitable entities.

An example is set out in this section of the Guidelines which illustrates how certain activities undertaken by the first type of umbrella organization, i.e. a charity established to assist other charities, would all be charitable at law because all of the beneficiaries of such services are exclusively charitable. However, where the exact same activities are carried out by the second type of umbrella organization, i.e. an umbrella organization that itself advances recognized charitable purposes, CRA indicates that some of them would not be acceptable as they would result in benefits being derived by non-charitable entities. As such benefits would not necessarily result in the application of additional resources to a charitable purpose, and would also be contrary to the *Act* itself, which precludes charitable property being used to benefit a non-qualified donee, such activities would not be found by CRA to be charitable. Presumably though, such a determination would only be made by CRA where, in fact, the particular umbrella organization in question was actually carrying on activities, in part, through non-qualified entities.

D. CHARITIES ESTABLISHED TO ASSIST OTHER REGISTERED CHARITIES

In describing charities established to assist other registered charities, CRA's comments in the Guidelines are practically identical to those set out in the earlier Proposed Guidelines. In relation to this type of umbrella organization, CRA describes them as those that are "promoting the efficiency and effectiveness of other registered charities" and makes clear that it views this as a valid charitable purpose. This is because CRA takes the position that "providing a service or assistance that directly improves the charitable programs of

[12] *Ibid.*
[13] *Ibid.*

other registered charities, that improves the efficient administration of other charities, or that enables charities to realize economies of scale that they could not achieve on their own, is charitable".[14] Such work by these types of umbrella organizations is viewed by CRA as being charitable because it improves the efficiency of charities, thereby increasing the amount of resources available to be used directly for charitable programs, and improves the effectiveness of charities by increasing their capacity to deliver programs and serve individual beneficiaries.

In relation to their beneficiaries, CRA's position is that a minimum of 90% of the beneficiaries and a minimum of 90% of this type of umbrella organization's resources must be directed to registered charities. This is unchanged from the Proposed Guidelines.

The Guidelines, in relation to the required formal purposes, indicate that this type of umbrella organization's objects "should be worded in such a manner that it is clear the object of the organization is to improve the efficiency and/or effectiveness of other registered charities". That being said, CRA makes clear in the Guidelines that merely including these particular words in its objects is not sufficient to be found charitable. Rather, the means must be clearly indicated in the objects of this type of umbrella organization to show exactly how they will improve the effectiveness and/or efficiency of other registered charities. Some examples of object wording that will be acceptable to CRA in this regard are set out in the Guidelines.

In relation to the activities to be undertaken to achieve the stated objects, the Guidelines indicate that this type of umbrella organization must demonstrate that its activities are a 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.

The Guidelines further indicate that this type of umbrella organization would report the direct costs of the services that it provides to other charities as a charitable expenditure on its annual information return (T3010A) filed with CRA. As well, where a beneficiary charity of the services of such an umbrella organization pays for the said services, the beneficiary charity is expected to categorize these payments accordingly on its own T3010A each year, for example the Guidelines explain that when a charity pays another charity for accounting service, the paying charity would report this as an administrative expense, as it

[14] *Supra*, note 1.

would not be strictly a gift to the recipient charity. These payments are not considered to be gifts to the umbrella organization.

E. UMBRELLA ORGANIZATIONS ADVANCING A RECOGNIZED CHARITABLE PURPOSE

The second type of umbrella organization addressed in the Guidelines are those which "are established to further a particular charitable purpose (other than assisting charities)" and, in carrying on their work, "may convey benefits on constituent groups as incidental to the achievement of that purpose". CRA indicates in the Guidelines that these types of umbrella organizations generally advance a charitable purpose that is related to a special issue, such as a particular subject of education (history/archeology/geography) or particular issue of health (fitness/disease prevention/therapy) in which all member organizations share a common interest. Some specific examples of this type of umbrella organization are historical societies or medical research and treatment organizations working to find a cure for a particular disease and assist those who are suffering from the said disease.

CRA describes these types of umbrella organizations as being "often hierarchically organized, consisting of a national or geographically defined body with provincial and/or local member. Membership is usually comprised primarily of registered charities, but may also contain non-registered entities that, for a variety of reasons, may not seek registration". For example, not for profit corporations pursuing a purpose that is not recognized as charitable under common law, or a charitable organization that is not located in Canada, but is still receiving support from the Canadian umbrella organization.

In order to be granted charitable status, the Guidelines make clear that the beneficiaries of the work of this type of umbrella organization "must be the public at large, or a sufficient segment thereof". That is, both the purposes (i.e. objects) and activities of the said umbrella organization "must be clearly and specifically focused on providing a direct benefit to the public *and not to members*." CRA indicates that umbrella organization of this type may have member groups that are a mix of registered charities and non-registered entities, such as non-profit groups. Such a structure is acceptable to CRA, provided that the "ultimate target beneficiary of the charitable service is the public." CRA cautions, though, that this type of umbrella organization has to be careful not to primarily or exclusively benefit its members because, where such benefits are received by the said members, the organization will either not be granted charitable status or could lose it if it is already registered as a charity.

The Guidelines state that the purposes of this type of umbrella organization "must always be expressed in relation to the charitable category that the organization is seeking to advance", such as advancement of education. Some specific examples of acceptable charitable objects are provided by CRA in the Guidelines. However, where an umbrella organization of this type has been established to merely provide support to its member groups, then it will not be able to be granted charitable status unless substantially all (i.e. 90%) of the said member groups are registered charities.

In relation to activities, all activities of this type of umbrella organization must achieve or advance a charitable purpose, although it is acceptable that the said activities "incidentally complement or supplement the work of its constituent groups". CRA states that "an activity can be said to achieve or advance a charitable purpose when the activity can reasonably be shown to result in an increase in the quantity, quality or availability of a charitable service to the public." Some examples of acceptable activities by this type of umbrella organization which further its legitimate charitable purpose are set out in the Guidelines.

The only key factor that CRA will examine in reviewing the activities of this type of umbrella organization is whether, and to what degree, any private benefit is being conferred on non-charitable beneficiaries, including non-profit entities, for-profit bodies or even individuals who are not legitimate charitable recipients. CRA explains in the Guidelines that "[c]onferring a private benefit is the use of charitable resources for an individual or entity's own advantage rather than a broader public advantage".[15] That being said, CRA does make clear that where the umbrella organization in question can show any private benefit provided is truly incidental to the achievement of its charitable purpose, then the said organization will remain eligible for registration as a charity.

CRA set out in the Guidelines what it characterizes as the "non-exhaustive guidelines" that may be used by it to determine whether a benefit is incidental, including two specific fact situations. CRA indicates that the key lesson to be learned from the said examples is that "charities must be extremely cautious when conferring benefits on organizations that are not registered charities",[16] with the consequences of engaging in such behaviour being either non-qualification for charitable registration (if a proposed charity), or monetary penalties and/or revocation of charitable status (if an existing charity).

[15] *Ibid.*
[16] *Ibid.*

The Guidelines set out several examples of acceptable activities by these types of umbrella organizations, as well as an explanation of how expenses are to be treated by them. CRA notes that this type of umbrella organization may have high levels of expenses that may appear administrative in nature, such as printing costs. However, in order to determine if the said expenses are, in fact, administrative as opposed to legitimate charitable ones, CRA states that the following analysis should be undertaken: "…what is the charitable purpose the organization is established for, and does the activity achieve this purpose? If yes, then the expense associated with the activity should be classified as a charitable expense on the T3010A."[17] Similar to the first type of umbrella organization, CRA indicates that the payment for services by beneficiary charities to umbrella organizations advancing a charitable purpose should be reflected as expenses and not as gifts to the said umbrella organization.

F. CHARITIES ESTABLISHED TO HOLD TITLE TO PROPERTY

The Guidelines also review a third type of related charity, being charities established to hold title to property on behalf of other registered charities. CRA indicates in the Guidelines that 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. For example, a church involved in potentially high risk activities, such as the operation of a day care or school, may wish, for asset protection purposes, to move its real property into a separate property holding corporation whose sole charitable purpose would be to provide land and buildings for the exclusive use of the Church and the pursuit of its charitable purposes. 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.

As was indicated in the earlier *Charity Law Bulletin* No. 78,[18] the recognition that organizations established to hold title can be charitable organizations, as opposed to charitable foundations as was the case under an earlier CRA policy, is an important development. This is because the earlier requirement for these types of charities to be only public foundations caused significant difficulties, since they would have been prohibited from incurring debt in acquiring the property(ies) in question. The ability for these types of entities to be

[17] *Ibid.*
[18] *Supra*, note 5.

charitable organizations will allow them to incur debt in taking title to property, thereby increasing the availability of asset protection arrangements for the charitable sector.

The Guidelines, as was the case in the Proposed Guidelines, continue to distinguish between two different types of title holding entities, namely a holding company for property "beneficially owned" by another related registered charity, as compared 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 the latter type is most likely to be characterized as the first type of umbrella organization, i.e. a charity established to assist other registered charities. In relation to the first type of title holding entity though, concerns that had been first raised in *Charity Law Bulletin* No. 78 have not been addressed in the Guidelines. That is, CRA's ongoing characterization of title-holding entities as ones that hold property that is "beneficially owned" by the tenant charity is problematic.

As described in more detail in *Charity Law Bulletin* No. 78, this concept of "beneficial ownership" by the tenant charity suggests that the title-holding entity is merely a bare trustee for the tenant charity (i.e. holding property in trust at the absolute disposal and for the absolute benefit of the tenant charity), as opposed to holding the said property for its own beneficial purposes. If such a bare trustee arrangement is in place between a property holding charitable entity and the tenant charity, then the original asset protection purpose of such an arrangement would be essentially lost. This is because any creditors of the tenant charity could raise seemingly valid arguments that the property in question should be subject to seizure, as it is beneficially owned by the tenant charity, not the title-holding entity. While it was hoped that this issue would be addressed, or at least clarified, in the Guidelines, CRA has decided not to do so.

However, while the issue outlined above was not corrected by CRA in the Guidelines, CRA did take steps to address another issue of concern in the Proposed Guidelines that had been identified in *Charity Law Bulletin* No. 78. That is, in the Proposed Guidelines, CRA had taken the position that beneficiaries of these types of title-holding entities must be one or more registered charities exclusively. As well, CRA had indicated in the Proposed Guidelines that the formal purpose of such a title-holding entity must be to provide a charitable service or benefit to the tenant charity and not merely hold title to property as this alone is not charitable at law.

In the Guidelines, this issue has been clarified by CRA in distinguishing between the purposes versus the activities of this type of title holding entity. In relation to formal purposes, CRA states that "simply holding title to property is not a charitable purpose on its own." Rather, the charitable objects (or purposes) of the title-holding entity must be "phrased in such a manner that it is clear that the property that is held (or income from the property, if applicable) is to be devoted to charitable purposes." CRA provided a sample of acceptable charitable objects for these types of entities to use in their incorporating documents, which includes naming the tenant registered charity directly in the said objects.

Then, in relation to activities, CRA acknowledges in the Guidelines that these types of entities can carry on varying degrees of activities, from simply holding title to the property of another registered charity to providing more comprehensive property management services. CRA states that it is its view "that the simple act of holding title to property on behalf of another registered charity is sufficient for registration purposes",[19] although it acknowledges that other forms of related activities may also be acceptable, provided that they can be shown to be charitable.

Finally, in relation to the reporting of expenses, CRA indicates in the Guidelines, as it did in the Proposed Guidelines, that title-holding entities may have difficulty meeting its disbursement quota. This is because the granting by the title holding entity of mere permission to the tenant charity to use the property in question does not constitute a legitimate charitable expenditure or a gift to a registered charity. In the commentary in *Charity Law Bulletin* No. 78 on the Proposed Guidelines, it was indicated that CRA's position on this issue was of concern.[20] It was explained that if the provision of services to other charitable is considered to be charitable for the first type of umbrella organization, i.e. charities established to assist other registered charities, then there was 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 has not been addressed in the final version of the Guidelines.

Instead, the Guidelines merely indicate that where a title-holding charity pays any expenses for the property, it must allocate the said expenses according to the use made of the property by the tenant charity. For example, if sixty percent of the property is used by the tenant charity for charitable purposes, then sixty percent of the

[19] *Supra*, note 1.
[20] *Supra*, note 5.

property expenses paid by the title-holding charity can be allocated as charitable expenditures on its T3010A. This explanation is new to the Guidelines.

Another new provision in the Guidelines is an explanation that where the tenant charity transfers funds to the title-holding entity, the tenant charity must also allocate the payments according to their use. The said payments between the two charities are not to be recorded as gifts, but rather as an occupancy cost of the tenant charity and rental income by the title-holding charity. As well, the Guidelines explain for the first time that, in relation to the 3.5 percent disbursement quota, where a property is used in the delivery of charitable programs or administration by a tenant charity, then the value of the property would not be subject to the said 3.5 percent calculation.

Finally, similar to the Proposed Guidelines, the Guidelines outlines some ways by which title-holding charities can avoid disbursement quota problems, as well as alternatives available to the title-holding entity under the *Income Tax Act* (Canada).

G. CONCLUDING COMMENTS

While it is recognized that the Guidelines are a constructive step forward in policy development by CRA in relation to umbrella organizations, there are still some concerns in relation to certain aspects of the Guidelines. It is hoped that CRA will continue to be responsive to comments from the sector in undertaking a fine tuning of the policy in future years.

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