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CHARITY LAW BULLETIN NO. 219

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JULY 29, 2010
Editor: Terrance S. Carter

CRA'S REVISED GUIDANCE FOR CANADIAN REGISTERED CHARITIES CARRYING OUT ACTIVITIES OUTSIDE CANADA

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A. INTRODUCTION

In June of 2009, the Canada Revenue Agency ("CRA") had released a draft consultation paper entitled *Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities*[1] (the "Proposed Guidance") and accepted comments until September 30, 2009.[2] Many organizations provided submissions to CRA on the Proposed Guidance, including the Charities and Not-for-Profit Law Section of the Canadian Bar Association ("CBA").[3] CRA has recently released the final version of the Guidance entitled *Canadian Registered Charities Carrying Out Activities Outside Canada* (the "Guidance"), effective as of July 8, 2010. The Guidance updates and replaces the previous CRA publication on foreign activities entitled *Registered Charities: Operating Outside Canada* RC4106 (the "Previous Policy"). The Guidance does not have the force of law, but is intended "to enable registered charities and applicants for

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[1] Canada Revenue Agency, *Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities*, May 6, 2008, available online at: http://www.cra-arc.gc.ca/tx/chrts/plcy/cnslttns/ccrc-eng.html.

[2] For a discussion of the Proposed Guidance, see *Charity Law Bulletin* No. 172, available at http://www.carters.ca/pub/bulletin/charity/2009/chylb172.htm.

[3] National Charities and Not-for-Profit Law Section of the Canadian Bar Association, *CRA Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities*, October 2009, available at http://www.cba.org/CBA/submissions/pdf/09-56-eng.pdf.

charitable registration carrying on activities outside Canada to understand the CRA's interpretation of, and expectations related to, the provisions of the *Income Tax Act* ("ITA") concerning charitable registration."[4]

As reflected in its title, the Guidance generally assumes that a charity working with an intermediary is doing so to carry on activities outside Canada. However, the Guidance is intended to apply to all activities carried on through intermediaries both outside and within Canada. In this regard, the Guidance refers to an upcoming CRA guidance entitled *Carrying Out a Charity's Own Activities Within Canada Through an Intermediary*. This upcoming publication should clear up any confusion about the requirements applicable to activities within Canada.

This *Charity Law Bulletin* summarizes the obligations of charities carrying on activities abroad, and provides commentary regarding the final version of the Guidance.

B. OBLIGATIONS OF CHARITIES CARRYING ON ACTIVITIES ABROAD

There are two means available under the *Income Tax Act* ("ITA") by which a registered charity can pursue its charitable purposes: (a) by making gifts to qualified donees; and (b) by carrying out its own charitable activities. It is generally not permissible for a registered charity to carry out its charitable purposes by merely giving money or resources to an organization that is not a qualified donee.

1. Gifts to qualified donees

A registered charity can make gifts to other organizations that are on the list of qualified donees provided for in the ITA. The Proposed Guidance defined a gift to a qualified donee as "a transfer of money or any other property to a qualified donee."[5] This definition reflected a relatively broad interpretation by CRA regarding gifts to qualified donees, in that it did not require the strict formalities of a gift to be present. This definition has been tightened in the final version of the Guidance, as the Guidance states "[a] gift to a qualified donee is a transfer of money or any other property to a qualified donee, *without consideration* (emphasis added)."[6]

[4] Canada Revenue Agency, *Canadian Registered Charities Carrying Out Activities Outside Canada*, July 8, 2010, available online at: http://www.cra-arc.gc.ca/tx/chrts/plcy/cgd/tsd-cnd-eng.html.
[5] *Supra* note 1 at para. 26.
[6] *Supra* note 2 at para. 5.4.

The simplest way to carry on activities outside Canada is for a charity to make a gift to a qualified donee that has the experience and capacity in the foreign country to carry on the activity. Qualified donees include the following organizations:

- Canadian registered charities;
- registered Canadian amateur athletic associations;
- registered Canadian national arts service organizations;
- housing corporations resident in Canada and exempt from tax under Part I of the ITA by paragraph 149(1)(i);
- municipalities in Canada;
- for gifts made after May 8, 2000, municipal or public bodies performing a function of government in Canada;
- prescribed universities outside Canada;
- the United Nations and its agencies;
- provincial and federal governments; and
- 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 immediately preceding that taxation year.

CRA's Information Circular *IC84-3R6 Gifts to Certain Charitable Organizations Outside Canada*, dated July 9, 2010,[7] provides information regarding gifts to latter group of foreign charities.

2. Charitable Goods Policy

The Guidance states that "[i]n certain limited circumstances, the CRA will consider a charity to be carrying out its own activities by transferring certain resources to a non-qualified donee."[8] This has previously been referred to informally as CRA's Charitable Goods Policy and reflects some of the guidance set out in the caselaw.[9] In these circumstances, all of the following conditions must be met:

- the nature of the property being transferred is such that it can reasonably be used only for charitable purposes (for example – medical supplies or school textbooks);
- both parties understand and agree that property is to be used only for the specified charitable activities; and
- based on an investigation into the status and activities of the non-qualified donee receiving the property (including the outcome of any previous transfers by the charity), it is reasonable

[7] Available at http://www.cra-arc.gc.ca/E/pub/tp/ic84-3r6/ic84-3r6-e.pdf.
[8] *Supra*, note 2 at para. 5.2.
[9] See *Canadian Magen David Adom for Israel v. Canada (Minister of National Revenue)*, 2002 FCA 323; and Registered Charities Newsletter No. 20, Fall 2004.

for the charity to have a strong expectation that the organization will use the property only for the intended charitable activities.

3. Carrying on its own charitable activities

If a charity carries on its own charitable activities, it must be actively involved in programs that are intended to achieve its charitable purposes. This is often done directly using the charity's own staff and volunteers. When a charity cannot carry out an activity directly, it may use an intermediary to carry out its activities. The Guidance sets out different types of acceptable intermediary relationships, but CRA does not recommend one type of relationship over another.

a) Agents

In an agency relationship, a charity can appoint an agent to act as its representative in carrying out specific tasks on behalf of the charity and, in doing so, transfers monies or other charitable resources to the agent. Agents can be organizations or individuals and do not need to be qualified donees under the ITA or registered charities in their own countries. Agency agreements can be one-time agreements or can be master agreements where there is to be a longer term relationship between the parties which are then supplemented by designations accompanying each transfer of funds. Agency arrangements have traditionally been the most common method used by registered charities to carry on activities outside of Canada through intermediaries.

There are a number of issues that should be considered when engaging an agent. The existence of an agency relationship may expose a charity to significant liability for the acts of its agent. Legally, the actions of the agent are deemed to be the actions of the principal and, as a result, the principal is thereby vicariously responsible for the actions of the agent. This vicarious responsibility for the acts of its agent can then expose the charity (as principal) to significant liability, both civil and criminal. Some insurers may have concerns about the vicarious liability risks associated with agency relationships. In this regard, the final version of the Guidance contains the following statement:

> "Registered charities should consider how they structure agency arrangements, since the existence of an agency relationship may expose them to significant liability for the acts of their agents. Even if there is no formal agency agreement in place, a court can attach liability to a registered charity if the court decides from the circumstances that an implied agency relationship exists."

Such a warning had been notably missing from the Proposed Guidance.

b) Joint ventures

A charity can also carry on its activities jointly with other organizations or individuals through a joint venture relationship where the participants pool their resources to accomplish a common goal in accordance with the terms of a joint venture agreement. The Guidance states that "a charity must be able to establish that its share of authority and responsibility over a venture allows the charity to dictate, and account for, how its resources are used."[10] How this will be accomplished though, is not altogether clear. This language has been revised following the consultation process, as the Proposed Guidance required that a charity's share of authority be at least proportional to the level of resources it contributes.[11] CRA will look at a joint venture as a whole, and a charity's participation in a venture, to make sure that the charity is only furthering its own charitable purposes. Appendix E to the Guidance contains a list of factors CRA will consider when examining joint venture arrangements.

c) Co-operative participants

"Co-operative participant"[12] is defined in the Guidance as "an organization that works side-by-side with a registered charity to complete a charitable activity." The organizations do not pool their resources nor carry out the project as a joint venture; instead, the charity and the other organizations each take on responsibility only for specific parts of the project. Nothing else is said in the Guidance about this relationship other than providing an example and, as such, users of the Guidance may feel unsure of what will and will not compromise a relationship involving co-operative participants.

d) Contractors

CRA permits a charity to contract with an organization or individual in another country to provide goods and services to achieve its charitable purpose. Contractors do not need to be qualified donees under the ITA or recognized charities according to the law of their own countries.

[10] *Ibid*. at para. 6.3.
[11] *Supra* note 1, para. 44.
[12] Previously referred to as co-operative partnerships.

However, the registered charity is required to give specific instructions to its contractors demonstrating adequate control and supervision.

There are important issues to consider when considering a contractor relationship. The vicarious liability that exists in an agency relationship does not generally exist with a contract for service between a charity and the intermediary with whom it contracts to provide services. This is because a contract is used to affect the relationship, rather than a principle/agent relationship. Any liability associated with the work being carried out by the contractor under the contract for service is generally limited to the contractor and does not extend back to the charity. However, it is still possible for the plaintiff in a lawsuit against a contractor and the charity to argue that the charity exercised too much day-to-day control over the activities of the contractor and, therefore, might possibly be liable for the actions of the contractor. In contrast to an agency relationship, a contract for service may be more attractive to an insurer as it does not generally involve vicarious liability for the actions of the contractor.

The sections in the Guidance dealing with agents and contractors do not address the practices of sub-agency and sub-contracting, which are currently allowed by CRA. In the "Questions and Answers" section of the Guidance, CRA acknowledges that the law does not restrict a charity from using sub-agency or sub-contractor agreements. However, if using such arrangements, CRA indicates that "a charity must still be able to direct and control the use of its resources through its relationship and agreements with the agent or contractor."

4. The "own activities" test

The key consideration that a charity must have when carrying on activities abroad is whether it meets the "own activities" test. The test is described in the Guidance as follows:

> "[a]part from making gifts to qualified donees, the *Income Tax Act* requires a registered charity to devote all its resources to charitable activities carried on by the organization itself. This requirement is referred to as the **own activities** test."

Charities cannot act as a passive funding body or conduit for a non-qualified donee. For the purposes of the Guidance, a conduit is "a registered charity that receives donations from Canadians, issues tax-deductible receipts, and funnels money without direction or control to an organization to which a

Canadian taxpayer could not make a gift and acquire tax relief." CRA warns that acting as a conduit violates the ITA and could jeopardize a charity's registered status.

One notable addition to the final version of the Guidance is an appendix dealing with head bodies located outside Canada. In Appendix C, CRA acknowledges that some charities are the Canadian representative of a larger foreign organization, which sometimes requires payments of tithes, royalties, memberships or similar transfers. However, charities cannot simply send payments to head bodies, affiliates or other member organizations without receiving goods or services in return. Based on the assumption that a Canadian charity benefits from access to resources from its head body, CRA allows payments of "small amounts" to a head body. The Guidance states that CRA "will probably consider a small amount to be whichever amount is less – 5% of the charity's total expenditures in the year or $5,000."[13] In its submission regarding the consultation on the Proposed Guidance, the CBA had recommended that the threshold for what constitutes a "small amount" be increased to $10,000.[14] Unfortunately, this recommendation was not adopted in the final version of the Guidance. As well, the Guidance deals only with payments to a head body and does not deal with payments to affiliates or other member organizations.

When transferring resources to an intermediary, a charity must direct and control the use of its resources to meet the "own activities" test. CRA recommends that a charity enter into a written agreement with any intermediary that it works with. In some cases, the agreement may only require a verbal discussion, while other situations will call for greater measures of control. The Guidance sets out six measures, which CRA recommends that charities adopt to direct and control the use of the charity's resources:

- Create a written agreement, and implement its terms and provisions;
- Communicate a clear, complete, and detailed description of the activity to the intermediary;
- Monitor and supervise the activity;
- Provide clear, complete, and detailed instructions to the intermediary on an ongoing basis;
- For agency relationships, segregate funds, as well as books and records; and
- Make periodic transfers of resources, based on demonstrated performance.

[13] *Supra* note 2, Appendix C.
[14] *Supra* note 3, at 13.

a) Written agreements

Although not formally required, CRA recommends that a charity have a written agreement with each of its intermediaries. However, simply entering into an agreement is not enough to prove that a charity meets the "own activities" test. The charity must also be able to show it has a real, ongoing, active relationship with its intermediary. Appendix F to the Guidance contains a checklist to help charities create a written agreement.

In situations where the money spent on a one time activity is $1,000 or less, the Guidance provides that other forms of communication might be used to show direction and control. Considering the expense involved in developing a written agreement, this exemption from the written agreement recommendation is a welcome addition to the Guidance that was not present in the Previous Policy. However, as noted by the CBA, "even disbursements of $1000 do not justify the expense of creating a specific written agreement."[15] Therefore, in its submission on the Proposed Guidance, the CBA recommended that the threshold be raised to $5,000.[16] Unfortunately, this recommendation was not adopted in the final version of the Guidance.

b) Description of activities

Before starting an activity, the charity and its intermediary should agree on a description of the activity. A charity should be able to documents the exact nature, scope and complexity of the activity. The Guidance lists what the description should demonstrate, including the following:

- Exactly what the activity involves, its purpose, and the charitable benefit it provides;
- Who benefits from the activity;
- A comprehensive budget for the activity, including payment schedules;
- The expected start-up and completion dates for the activity, as well as other pertinent timelines;
- A description of the deliverables, milestones, and performance benchmarks that are measured and reported;
- How the charity monitors the activity, the use of its resources, and those who carry on the activity; and
- The mechanisms that allow the charity to modify the nature or scope of the activity, including discontinuance of the activity if the charity so decides.[17]

[15] *Ibid*, at 11.
[16] *Ibid.*
[17] *Supra* note 2 at para. 7.3.

c) Monitoring and supervision

The Guidance states that monitoring and supervision is "the process of receiving timely and accurate reports, which allows a charity to make sure that its resources are being used for its own activities." Depending on the size nature and complexity of the activity, the reporting methods can take many forms, including progress reports, receipts for expenses and financial statements, informal communications via telephone or email, photographs, audit reports, on-site inspections by the charity's staff members. The method of reporting should be set out in the written agreement.

d) Ongoing instruction

Charities are expected to provide ongoing instructions to their intermediaries to provide any necessary additional instructions or directions to the intermediary. Written records, such as minutes of meetings are one way to show that a charity has given ongoing instructions to the intermediary and continues to control the activities. CRA recommends using written instructions to communicate with an intermediary whenever possible.

e) Periodic transfers

The Guidance recommends making periodic transfers of funds based upon demonstrated performance, rather than sending funds to an intermediary in one transfer. A charity should retain the right to discontinue the transfer of funds and to have unused funds returned if the charity is not satisfied with the reporting, progress, or outcome of an activity.

f) Separate activities and funds

The Guidance points out that a charity must make sure that it can distinguish between its activities and those of its intermediary when carrying on activities through an intermediary. A charity cannot simply pay the expenses that an intermediary incurs to carry on the intermediary's own programs and activities. For certain types of arrangements, such as agency arrangements, the charity's funds should be kept in a separate bank account. Segregated funds should also be reported in books and records separately from those of the intermediary. The Guidance acknowledges that some regions have rudimentary banking systems or a charity's staff or an intermediary may not be able to access a banking system. In a situation where funds cannot be kept separate, a charity should be able to provide other evidence to distinguish its own resources and activities.

5. Keeping books and records in Canada

Charities must keep adequate books and records in Canada. CRA recommends that books and records be kept in either French or English. The books and records must have enough information to allow CRA to determine if the charity is operating in accordance with all the provisions of the ITA. In *eBay Canada Ltd. v. Canada (National Revenue)*, 2008 FCA 348, the Federal Court of Appeal ("FCA") ruled that electronic information kept on servers located outside Canada was not "foreign based." The FCA reasoned that in the modern age, electronic information is just as accessible as records physically present in Canada. Notwithstanding the *eBay* decision and the advances of modern technology, the CRA still maintains its position that "charities must keep their books and records at an address in Canada."[18]

The section on books and records in the Guidance is quite short. The Proposed Guidance set out the specific requirements for books and records with regards to agency, contracts for services and joint venture arrangements, including the ongoing burdensome requirement that an intermediary must produce a final comprehensive report, including supporting receipts, invoices and vouchers at the end of a charitable program. These provisions have been removed from the final version of the Guidance, but the Guidance remains inconsistent regarding the requirement to provide original source documents. The Guidance states that the ITA does not require a charity to provide original source documents, such as receipts. However, CRA recommends that a charity obtain original source documents whenever possible. CRA acknowledges that providing original source documents may not always be possible or practical, particularly in situations where war, natural disaster, lack of access to telephones or the internet, low literacy rates, legal restrictions, or other conditions make it impossible for charities to obtain original documents. Yet in these situations, a charity is expected to explain why it cannot obtain original source documents, and make all reasonable efforts to obtain copies and/or reports and records to support its expenditures. A charity must also be able to show that it has made such efforts.[19] Therefore, from a practical standpoint, the onus is still on the charity to produce the original source documents unless it can provide a reasonable explanation otherwise.

[18] *Supra* note 2 at para. A.3, Questions and Answers.
[19] *Ibid.* at para. 8.1.

6. Foreign activities and the disbursement quota

The Guidance confirms that the disbursement quota is not affected by whether the charity is carrying out activities in Canada or in a foreign country. A charity should report all amounts spent by its intermediaries as if they had been spent by the charity itself. A charity with foreign activities must also complete *Schedule 2, Activities Outside Canada*.

The Guidance states that "if a charity is working jointly with other organizations, it must account for all charitable and other expenditures it occurs when carrying on an activity."[20] In this regard, the Guidance provides an example of a charity that is engaged in a joint venture with a foreign organization that is not a qualified donee. The charity contributes $10,000 annually to the project, of which $9,000 goes toward charitable activities and $1,000 covers administrative costs. According to the example, the charity can apply $9,000 towards its disbursement quota, but must record the remaining $1,000 as administrative costs, meaning that the charity cannot count the entire amount sent to the foreign intermediary towards meeting its disbursement quota.

Based on the example provided in the Guidance, a charity would have to carefully monitor the allocation of monies and resources sent to foreign intermediaries in order to calculate its disbursement quota. It appears that CRA's rationale is based on situations where agency or a joint venture are involved. However, the Guidance does not specifically deal with situations involving contracts for services, which are of a different nature than other intermediary relationships. The requirement to parse a contractor's expenses would not be a regular part of a contractual relationship. Therefore, the entire amount transferred under a contract for service should be counted for disbursement quota purposes. However, the Guidance does not provide clarity on this issue.

Given the proposed repeal in the 2010 Federal Budget on March 4, 2010 of the 80% disbursement quota (DQ) and other proposed changes to simplify the DQ rules, it is not clear what is the continued relevance of this section in Guidance at all, particularly since for most charitable organizations operating abroad, the 3.5% DQ will present few, if any, problems. As such, the discussion in this part of the Guidance seems to be contrary to the purpose of the recent legislative initiative.

[20] *Ibid*., at para. 10.

7. Additional issues

a) Local laws

Charities operating within Canada must comply with Canadian laws. Charities operating outside of Canada may be operating in areas where the laws are very different. Like the Proposed Guidance, the Guidance states that the ITA does not require charities to comply with laws in foreign jurisdictions. However, being a registered charity in Canada does not exempt a charity from the laws in the jurisdiction in which they operate. CRA strongly suggests that all charities make themselves aware of local laws, and how they are enforced, before operating abroad.

b) Activities that put people at risk

The Guidance contains a section not included in the Proposed Guidance under the heading "What if a charity's activity puts people at risk?" The Guidance states "[i]f an organization's activity is likely to result in harm to the charity's staff, the beneficiaries of its programs, or any other person, this harm is taken into consideration when assessing whether the public benefit test is met."[21] A charity or applicant for charitable status should be able to show an awareness of the level of risk an activity poses versus the benefit that can be provided. The Guidance provides the following list of the types of factors CRA will usually examine:

- The likelihood and nature of harm to anyone delivering the activity, receiving the benefit, or otherwise affected;
- The urgency of the need for charitable assistance (for example – an activity that helps desperate people in regions affected by a disaster, or in war zones);
- The experience of the charity or applicant operating in situations with significant risk; and
- The charity's proposed measures to mitigate any significant risks.

c) Canada's anti-terrorism legislation

The Guidance contains a section on compliance with Canada's anti-terrorism legislation. The Guidance reminds charities that they are responsible to ensure that they do not operate in association with individuals or groups that are engaged in terrorist activities or that support terrorist activities.[22] The Guidance also contains a link to the CRA checklist designed to help charities identify vulnerabilities to terrorist abuse, a reference which was missing from the

[21] *Supra* note 2 at para 4.2.
[22] *Ibid.*, at para. 4.3.

Proposed Guidance. In addition to referencing the *Charities Registration (Security Information) Act*, the Guidance notes that there are other prohibitions on funding or otherwise facilitating terrorism. The Guidance directs charities to see the *Criminal Code*, the *Regulations Implementing the United Nations Resolutions on the Suppression of Terrorism*, and the *United Nations Al-Qaeda and Taliban Regulations*.

d) Funding from the Canadian International Development Agency and other government organizations

The Guidance points out that not all projects funded by the Canadian International Development Agency ("CIDA") and other government organizations will be considered charitable. Therefore, the participating charity must ensure that the project meets its own charitable purposes. CRA recommends contacting the Charities Directorate in situations of uncertainty regarding CIDA-funded projects to determine if it is charitable.

Although not all projects funded by CIDA are charitable, "there may be overlap between the terms of a CIDA agreement on reporting and oversight, and the requirements described in the Guidance."[23] In this regard, CRA states in the "Question and Answer" section of the Guidance that "[i]f a CIDA report contains enough evidence that the charity is carrying out its own activities, the charity can provide this report to the CRA in the course of an audit or other investigation."[24]

C. CONCLUSION

The Guidance constitutes a significant improvement over the Previous Policy by providing a more practical guide for charities that operate outside of Canada. In addition, the final version of the Guidance contains several improvements over the Proposed Guidance. However, the requirements set out in the Guidance are still more restrictive and burdensome than is necessary or required by the caselaw to ensure compliance with the ITA. Charities carrying out international activities or sending money abroad are still faced with many onerous and expensive requirements that should be carefully considered when embarking upon operations abroad. Even though the Guidance became effective as of July 8, 2010, CRA is still accepting comments. Those with comments or suggestions that would help CRA improve the Guidance may email consultation-policy-politique@cra-arc.gc.ca.

[23] *Supra* note 3, at 4.
[24] *Supra* note 2 at para. A.5, "Questions and Answers."

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