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IDENTIFYING FIVE OF THE TOP LEGAL AND RISK MANAGEMENT CHALLENGES FOR 2012

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The charitable sector has been very busy in 2011, and with the dawning of a new year, charities will want to turn their attention to new challenges ahead. The following is therefore a brief summary of five of the top anticipated legal and risk management challenges for charities for 2012:

1. Anticipating CRA's New Fundraising Guidance;
2. Implications of the 2011 Federal Budget Concept of "Ineligible Individuals" for Directors, Officers, and Managers;
3. Working with Intermediaries Inside and Outside of Canada;
4. New Challenges Involving Inter-Charity Transfers; and
5. Reducing Risks from the Discipline and Expulsion of Members.

1. Anticipating CRA's New Fundraising Guidance

Canada Revenue Agency's ("CRA") Guidance (CPS-028): *Fundraising by Registered Charities* ("Guidance") is in the process of being revised into a new draft Fundraising Guidance. While the new Guidance is not yet available, it is likely to be released early in 2012. The new Guidance is expected to be a significant improvement but will be a longer document at approximately 38 pages compared to the current version's 31 pages. Given this, it will be important for charities to be familiar with the entire document, including all appendices at the end of the Guidance, once it becomes publicly available. Although improved, the new Guidance is anticipated to still be a complex document and will therefore require careful reading. CRA has advised that the new Guidance will not represent a new policy position but rather will provide

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information on their current treatment of fundraising under the *Income Tax Act* ("ITA") and common law. The new Guidance will provide general advice only and will be based on principles established by caselaw that fundraising must be simply a means-to-an-end, rather than an end-in-itself. The new Guidance will apply to all registered charities and to both receipted and non-receipted fundraising. An organization that is carrying out unacceptable fundraising may result in a denial of charitable registration or, for existing registered charities, sanctions or even revocation of charitable status. Watch for the release by CRA of the new Guidance early in the new year. For more details on the new Guidance, see the presentation by Terrence S. Carter entitled "Complying with CRA's New Fundraising Guidance" at http://www.carters.ca/pub/seminar/chrchlaw/2011/index.htm.

2. Implications of the 2011 Federal Budget Concept of "Ineligible Individuals" for Directors, Officers, and Managers

The 2011 Federal Budget, which passed in the House of Commons on November 21, 2011 and received second reading in the Senate on November 24, 2011,[1] includes several provisions that will be of significance to the charitable sector. These provisions, entitled "Strengthening the Charitable Sector", introduced a number of changes to the regulatory regime affecting registered charities. One of the most significant of these changes is the introduction of provisions rendering certain individuals to be ineligible to serve on the board of or in a senior capacity within a registered charity.

The "ineligible individual" provisions came as a result of concerns from CRA that applications for charitable status were being submitted by individuals who had previously been involved with charities that had their charitable status revoked for serious non-compliance issues. The Department of Finance has introduced the concept of "ineligible individuals" to the ITA, which will enable CRA to withhold or revoke charitable status of organizations that have ineligible individuals on the board or serving as a senior manager, in order to better safeguard charitable assets.

As a result of ITA amendments, if an "ineligible individual" is a member of the board of directors, a trustee, officer or equivalent official, or any individual who otherwise controls or manages the operation of the

[1] Bill C-13, *Keeping Canada's Economy and Jobs Growing Act*, 1st Sess, 41st Parliament, 2011, available at http://www.parl.gc.ca/HousePublications/Publication.aspx?Docid=5155334&file=4. It should be noted that this legislation implements the changes that were proposed in the 2011 Federal Budget, which was adopted back on June 7, 2011.

charity, then the charity may have its charitable status refused or revoked or may have its authority to issue charitable receipts suspended.

Unfortunately, the addition of the "ineligible individual" provisions will now create another compliance burden for charities, their directors, officers, as well as their managers in the operation of a charity. This screening process may become a disincentive for individuals who would like to serve on the boards of charities and may cause difficulties in the future for charities trying to recruit new directors.

For more information, see *Charity Law Bulletin. No 245* at http://www.carters.ca/pub/bulletin/charity/2011/chylb245.pdf, and *Charity Law Bulletin No 253* at http://www.carters.ca/pub/bulletin/charity/2011/chylb253.pdf.

3. Working with Intermediaries Inside and Outside of Canada

Many charities run into difficulties when subjected to a CRA audit in accounting for transfers of funds or property to third party intermediaries that are not registered charities, whether the intermediaries are located inside or outside of Canada. To avoid problems in this regard, CRA has released two Guidances dealing with transfers to intermediaries.

Guidance (CG-004): *Using an Intermediary to Carry out a Charity's Activities within Canada* ("Guidance 004") was released by CRA on June 20, 2011. Guidance 004 assists charities and applicants for charitable status who are intending to conduct charitable activities through an intermediary within Canada. For the purposes of Guidance 004, an intermediary is defined by CRA as an individual or non-qualified donee (e.g. not a registered charity). Guidance 004 clarifies that CRA's administrative Guidance concerning operating outside Canada applies equally within Canada as well.

In this regard, on July 8, 2010, CRA released Guidance (CG-002): *Canadian Registered Charities Carrying Out Activities Outside Canada* ("Guidance 002"). Guidance 002 updates and replaces the previous CRA publication on foreign activities, *RC4106 – Registered Charities: Operating Outside Canada*. Failure to comply with the provisions of Guidance 002 constitute one of the most common ways in which a charity operating outside of Canada can be sanctioned or lose its charitable status.

In essence, both Guidance 002 and Guidance 004 say the same thing, in that there are only two means available under the ITA by which a registered charity can pursue its charitable purposes, either by making gifts to a qualified donee (e.g. Canadian registered charities) or carrying out their own charitable activities. If the charity is using a third party intermediary to carry out the charity's own activities, then the said two Guidances set out the minimum requirements that CRA expects to see in place. Essentially, charities cannot simply act as a passive funding body or conduit on behalf of a non-qualified donee. Instead, charities must direct and control the use of its own resources.

For more information on working through intermediaries in Canada, see *Charity Law Bulletin No 259* at http://www.carters.ca/pub/bulletin/charity/2011/chylb259.htm, and for more information on carrying out activities outside of Canada through intermediaries, see *Charity Law Bulletin No 219* at http://www.carters.ca/pub/bulletin/charity/2010/chylb219.htm.

4. New Challenges Involving Inter-Charity Transfers

New inter-charity transfer provisions came into effect as a result of reform to the disbursement quota ("DQ") that occurred in the 2010 Federal Budget. Subsection 149.1(4.1)(d) was expanded to include instances where a charity receives a gift of property from a non-arm's length registered charity, and the recipient charity has expended an amount that is less than the fair market value of the property on charitable activities by the end of the next fiscal period. In essence, this provision establishes a 100% expenditure requirement involving inter-charity transfers between non-arm's length registered charities. The consequence of failing to comply with these provisions can lead to the revocation of charitable status or the charity may also be liable for a penalty for that subsequent taxation year equal to 110% of the difference between the fair market value of the property and the additional amount expended. However, if the donor charity chooses to make the gift a "designated gift" to the non-arm's length recipient charity, the 100% expenditure requirement will not apply.

As a result, before a charity makes a transfer of anything (whether it be money, property, etc.) to a non-arm's length registered charity, such as between an operating charity and a parallel foundation, it will be important to ask whether or not it will need to make the transfer a designated gift in order to avoid the new 100% expenditure requirement. It should be noted that this expenditure requirement is in addition to the 3.5% DQ.

5. Reducing Risks from the Discipline and Expulsion of Members

Often charities, as well as non-profit organizations, will want the ability to discipline or expel a member. However, those organizations may not have thought through what is involved in doing so or what the consequences are of improperly undertaking discipline or expulsion of members. This issue will generally be a factor for open membership organizations, as opposed to those that are closed membership. The legal risks include, but are not limited to: possible liability for invasion of privacy, liability for discrimination, liability for lack of due process, liability for lack of natural justice, and enhanced membership rights under applicable corporate legislation concerning discipline. Practical steps may be taken to avoid the risks from disciplining or expelling members. These practical steps may include: determining whether it is actually necessary for the organization to discipline its members, advising applicants that the granting of membership status is in the sole discretion of the board of directors, ensuring discipline procedures reflect the principles of natural justice, and ensuring discipline processes are as detailed as possible and set out in a written policy of the organization or in its general operating by-law. This will be particularly important for charities that continue under either the *Canada Not-for-profit Corporations Act*,[2] which came into effect on October 17, 2011, or under the Ontario *Not-for-Profit Corporations Act*,[3] which will come into effect at the end of 2012. Both Acts provide for the power to discipline a member or terminate their membership, which power and the circumstances and manner in which it will be exercised must be set out in the articles or by-laws of the corporation.

For a more detailed description of the five challenges described above, reference can be made to a presentation given to Imagine Canada on November 8, 2011 by Terrence S. Carter, available at: www.carters.ca.

[2] SC 2009, C 23 at s 158.
[3] SO 2010, C 15 at s 51.