Hospitals:
A Unique Charitable Sector

Maureen Kidd, Director-General, Charities Directorate, CRA

Healthcare Philanthropy Seminar
February 10, 2004

Agenda

- The Framework
- The Charitable Sector Profile
- Accountabilities Under the *Income Tax Act*
- Specific Areas of Concern
- Charities Regulatory Reform

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The Framework

CRA and the Charitable Sector

- Under the Constitution, responsibility of charities is largely provincial:
  - Only Ontario and Alberta play an active oversight role in management of charities
  - Role usually consists of protection of charitable property (i.e. the enforcement of trust law)
  - As a general rule, provinces rely on the federal registration system
- The federal role is perceived as the only substantive regulation of charities and mainly related to the tax system:
  - Decisions on what organizations become registered for tax purposes
  - Decisions on nature of tax benefit (currently, pay no tax and issue receipts for tax credit to donors)
  - Also a gatekeeper – definition and regulation of the sector is tax-driven

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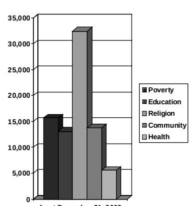
The Charitable Sector Profile

The Charitable Sector in Canada by Heads of Charity

- **1st Head: Relieving Poverty – 20%**
  - Welfare organizations providing care other than treatment – e.g., soup kitchens
  - Disaster funds
- **2nd Head: Advancing Education – 16%**
  - Universities, schools
  - Research
  - The arts
- **3rd Head: Advancing Religion – 40%**
- **4th Head: Other Benefits to Community - 17%**
  - Libraries, Museums
  - Animal Welfare
  - Emergency Services
  - **Promotion of Health – 7%**

- Health related charities compared by number to other types of charities in Canada



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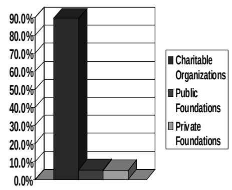
The Charitable Sector in Canada by Designation

- **80,580 Registered charities**
- 89.6% Charitable organizations
  - primarily carry on their own charitable activities
  - e.g., hospitals
- 5.4% Public Foundations
  - 50% or more of their income annually goes to qualified donees (other registered charities)
  - e.g., hospital foundations
- 5.0% Private Foundations
  - Own activities or fund charities
  - Either non-arms length board or are funded primarily from non-arm's length source
  - e.g., named after benefactor



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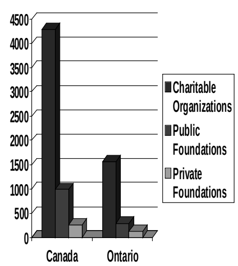
The Healthcare Charities

- Charitable Organizations
  - Hospitals; Research in particular disease, ailment, or affliction
  - e.g., *The Hospital for Sick Children*
- Public Foundations
  - Supporting one hospital (Parallel) or multiple hospitals
  - e.g., *The Hospital for Sick Children Foundation*
- Private Foundations
  - Named after benefactor
  - e.g., *Hospital for Sick Children Trust Re: John Ross Robertson Endowment.*



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Types of Healthcare Charities

- Hospitals
  - Children's; Convalescent/Rehabilitation; Hospice; Nursing home providing treatment; Psychiatric
- Services Other than Hospitals
  - Association for Community Living; Community Health Centre; Dental Clinic; First Aid Service; General health promotion; Hospital's Foundation; Mutual/peer support; Specific disease/health condition (e.g. Canadian Cancer Society); Palliative care; Research Institutes; St. John's Ambulance; Victorian Order of Nurses
- Health Foundations
  - Foundations to fund/support medical research; Foundations to support other medical/health charities
- Other Health Organizations
  - Hospital Auxiliaries; Health Councils; Health Boards; Voluntary Associations for specific hospital

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Healthcare Charities Impact Summary

- The voluntary sector = approx. 180,000 non-profits which include 80,000 registered charities, of which 5,500 are healthcare charities (7% of Canadian registered charities).
- The voluntary sector has an estimated $90 billion in annual revenues, with $109 billion in assets.
  - [Panel on Accountability & Governance in the Voluntary Sector, *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector*, 1999, pp.13]
  - **36% of the revenues ($32.4 billion) are spent in hospitals and health charities.**
  - [Canadian Council on Social Development, "Funding Matters" Appendix B: Portrait of the Non-profit and Voluntary Sector, by Katherine Scott, p.170]
- Approximately 5.5 million Canadians donate over $5.8 billion annually to registered charities.
  - [Statistics Canada website]
- This amounts to at least $1.9 billion in foregone revenue for the federal government.
  - [Based on Department of Finance: *"Tax Expenditures & Evaluations 2003: Estimates and Projections"*]

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Accountabilities Under *Income Tax Act*

To be registered as a charity

- Applicant must:
  - be resident in Canada and created or established in this country
  - be constituted and operated for charitable purposes
  - apply its resources exclusively toward achieving these purposes
  - ensure that individuals with ties to the applicant do not profit from their association with it

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Registered charities must

- Annually spend a minimum amount (i.e. 80% of their previous year's receipted donations) on its own charitable activities or in grants to certain other organizations (primarily other registered charities)
- Keep adequate books and records at a Canadian address which is recorded with CRA
- Follow ITA and Regulations when issuing official donation receipts
- File annual information return giving information on its activities, directors, and finances

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Specific Areas of Concern

- Private Interest
  - Gift provides direct and private benefit back to donor, or to persons in whom the donor has a personal interest.
- Patents
  - Who benefits from the work? Who holds the copyrights, patents, or licences? What happens when staff member patents product produced while working at or for your charity?
  - Is this a business activity? A related business?
- Return of Gifts
  - When purpose for which funds were raised is no longer viable/impossible.
- Sponsorships
  - Are the funds transferred 'gratis' or is there expectation of return back to business?
- Other Issues - Amalgamations, Split-receipting, Related business

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Charities Regulatory Reform

Background: CRA and Regulatory Reform

- Regulatory Reform and CRA Interest
  - CRA regulates Canada's charitable sector by administering the charity tax treatment provisions contained in the *Income Tax Act* (determine eligibility for charitable status, process annual charity information returns, ensure compliance)
- Calls for reform
  - Panel on Accountability and Governance in the Voluntary Sector
  - Report of the 1999 Joint Tables: *Working Together*
  - Voluntary Sector Initiative (VSI)
    - Joint Regulatory Table (JRT) review exercise

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Background: JRT

- JRT established to review regulatory environment for charities and make recommendations for potential action by government
- JRT members drawn in equal numbers from government (7 departments represented) and the sector
- Discussions centered on four areas:
  - Accessibility and transparency of the federal regulator (currently CRA), including making information it holds about charities available to the public
  - Access to appeals for organizations that disagree with decisions made by the regulator
  - Compliance reforms, such as the possibility of introducing new sanctions to ensure charities meet their legal obligations
  - Institutional models for regulating charities federally

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Background: JRT

The Consultation Process:

- JRT met 13 times to conduct policy research analysis and complete the report
- JRT released interim report in August 2002 to solicit comments and advice before finalizing recommendations
  - Public forums held in 21 locations across Canada in fall 2002
  - 388 local, regional and national organizations consulted
  - 24 formal submissions received

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Examples of JRT Recommendations

Accessibility and transparency:

- Publish explanations for all CRA charitable status decisions
- Release documents submitted by applicants whose registration is denied
- Allow CRA to release the financial statements charities file with their annual returns

Appeals:

- Create a new reconsideration unit within CRA's Appeals Branch
- Establish an appeal fund to bring forward test cases to higher courts

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Examples of JRT Recommendations

Sanctions:

- Introduce intermediate sanctions to deal with types of non-compliance that may not be severe enough to warrant revocation of registered charity status

Institutional Reform:

- Continue to confine the federal regulator's role to administering charity provisions of the *Income Tax Act* – but introduce reforms to enhance the effectiveness of the regulator

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Current Status: JRT

- JRT report publicly released by Ministers Caplan and Manley May 5, 2003 and distributed widely within government and the sector
- Joint news release welcoming report issued by Ministers Caplan and Manley (posted on CCRA and VSI websites)
- Implications of review exercise for CCRA:
  - regulatory framework can be modernized while protecting the integrity of the tax system, enhancing the accountability of charities and encouraging support of Canada's charitable sector

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Current Status: JRT

- Finance and CRA officials are currently reviewing the report and evaluating the proposals for change
- Development of response to the JRT Report underway – initial thinking is that the JRT made many practical, workable recommendations
- Report is a good basis for progress

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Characteristics of a Modern Regulatory System

- Ensures continued public support for charities and the good work they do
- Gives the public confidence that CRA is effectively monitoring the activities of charities and that monies raised for charity are being used for that purpose
- Achieves the proper balance between building a supportive regulator-client relationship to promote voluntary compliance and ensuring CRA fulfills its enforcement responsibilities while maintaining:
  - Public trust in charities
  - Public trust in the regulator
  - Sector trust in the regulator

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Desired Future State

- Elements of a modern regulatory system
  - Improved service to enhance transparency and accessibility of information about charity practices and regulatory decision-making
  - Introduction of an enforcement continuum to fully support voluntary compliance through client-centred service, while identifying and forcefully responding to practices that break the public trust
  - Modern system of reconsideration to ensure fair and impartial review of regulatory decisions
  - Enhanced focus on partnership and co-operation to promote public confidence in the role of charities in Canadian society

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HOSPITALS AND FOUNDATIONS SERIES

Health Care Philanthropy: Challenges and Solutions

Toronto – February 10, 2004

Recent Changes To the *Income Tax Act* and CRA Policies Affecting Charities

By Terrance S. Carter, B.A., LL.B.

OVERVIEW OF PRESENTATION

- Summary of Additions and Changes to CRA Website from 2002 to 2004
- Selected Discussion of Income Tax Amendments Affecting Charities
- Selected Discussion of New Policies From CRA Affecting Charities
- Other New Developments Affecting Charities

Note: This power point presentation provides an updated summary of excerpts from paper entitled "Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts" dated November 19, 2003 available at www.charitylaw.ca

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A. SUMMARY OF ADDITIONS AND CHANGES TO CRA WEBSITE IN 2002 & 2004

- Refer to: www.cra-adrc.gc.ca/tax/charities/menu-e.html for all CRA resource materials
- Changes to the CRA website cover the following topics:
  - Legislative Amendments
  - Circulars
  - Information Letters
  - Policy Statements
  - Bulletins
  - Brochures
  - Newsletters
  - Summary Policies

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- Guidelines
- Fact Sheets
- Interim Memorandums
- Consultation Papers
- Future Directions
- Press Releases
- Joint Regulatory Table Report

• What follows is a selection of CRA materials published with regards to charities from 2002 - 2004

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B. SELECTED DISCUSSION OF INCOME TAX AMENDMENTS AFFECTING CHARITIES

1. New Definition of Gift

• The traditional common law definition of a gift requires:
  - The donor must have an intention to give
  - There must be a transfer of property
  - The transfer must be made voluntarily without contractual obligation
  - No consideration or advantage can be received by the donor

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• Therefore a contract to dispose of property to a charity at a price below fair market value would not generally be considered a gift at common law for which a charitable receipt could be issued for the difference in price

• Similarly, a gift to a charity that entitles the donor to receive a benefit of a material nature would not be a gift at common law for which a receipt could be issued even if the value of the gift significantly exceeded the benefit received

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- **Draft amendments to the *Income Tax Act* in December of 2002 creates a new concept of "gift" for tax purposes which permits a donor to receive a tax credit under the Act even though the donor receives a benefit, provided that the value of the property exceeds the benefit received by the donor**
- **However, the idea that a gift can provide a benefit back to the donor is foreign to the common law concept of a gift**
- **The draft amendments reflect an importation of the civil law concept of gift which permits a benefit back to the donor**

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- **While a gift with an advantage may be deemed a gift under the *Income Tax Act*, it will not be a gift at common law and therefore there will be no transfer of title**
- **Utilizing a contract in order to transfer title may raise questions of donative intent that could preclude a gift for tax purposes**
- **In order to document the transfer of title where there is an advantage to the donor, and the expectation of a charitable receipt, the alternative of doing so by making use of a charitable trust should be considered**

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2. New Split-Receipting Rules

- **The key requirements of what will be recognized as a gift for income tax purposes for split receipting based on the new definition of gift are as follows:**
  - **There must be voluntary transfer of property with a clearly ascertainable value**
  - **Any advantage received by the donor must be clearly identified and its value ascertainable**

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- **There must be a clear donative intent by the donor to benefit the charity**
- **Donative intent will generally be presumed provided that the fair market value of the advantage does not exceed 80% of the value of the gift**
- **The eligible amount of a gift will be the excess of the value of the property transferred over the amount of the advantage received by the donor**

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- **The amount of the advantage is the total value of all property, services, compensation or other benefits to which the donor is entitled as partial consideration for the gift**
- **Excluded from the value of the advantage is token consideration for the gift calculated on the basis of a "*de minimis* threshold" of the lesser of 10% of the value of the gift and $75.00**

- **The charitable receipt will now need to identify the advantage and the amount of the advantage as well as the eligible amount of the resulting gift**

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- **A receipt can be issued where the advantage received by the donor (less any token consideration based upon the "*de minimis* threshold" of the lesser of 10% of the value of the gift and $75.00) does not exceed 80% of the value of the gift.**
- **December 20, 2002 and December 5, 2003 announcements introduced proposed legislation to implement split-receipting provisions in the *Income Tax Act***
- **For example, the ticket price for a table of 8 at a fundraising dinner is $2,000.00, the fair market value of the dinner is $800.00, the value of complimentary items; i.e., the door prizes and table gifts is $300.00**

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Total price for a table of 8		**$2000.00**
Less:		
- value of dinner	**$800.00**	
- complimentary items	**$300.00**	
(complimentary items exceed the lesser of 10% of $2000.00 or $75.00)		
Total value of advantage received by the donor		**$1,100.00**
Eligible amount of charitable receipt		**$ 900.00**

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- **Appraised value at auctions**
  - **Generally, since the bid value at an auction is considered to be the fair market value, normally no charitable receipt can be issued for an auctioned item**
  - **However, when the value of an item can be clearly determined and disclosed to all bidders in advance, the eligible amount for receipting would be the difference between the amount bid and the posted value**
  - **Where donative intent is established (i.e. in instances where the posted value of the item is not more than 80% of the accepted bid), a receipt may be issued for the eligible amount**

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- **Purchases of service at auction**
  - **Where a purchased service has an established fair market value that has been identified to all bidders at the auction before the opening bid, a receipt can be issued to the purchaser for the "eligible amount" where donative intent exists**
  - **The eligible amount is the difference between the amount paid and the amount of advantage (value of the service)**

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3. Charitable Annuities:

- **CRA indicated in Technical News No. 26 in December 2002 that the previous administrative position with regard to charitable annuities has no basis in law and cannot be continued as a consequence of the amendment to subsection 248(33) of the *Income Tax Act***
- **Instead, a new administrative policy has been proposed which provides for a charitable receipt based on the difference between the cost of the annuity and the gift, rather than the difference between the anticipated annuity payments and the amount of the gift**

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Facts:

- **A donor makes a $100,000 contribution to a charitable organization**
- **The donor's life expectancy is 8 years (and the donor lives 8 years)**
- **The donor is to be provided annuity payments of $10,000 per year (total of $80,000)**
- **The cost of the annuity to provide the $80,000 payment over 8 years is $50,000**

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Former tax treatment under IT-111R2	**Proposed tax treatment under Technical News No. 26**
• the donor receives a tax receipt of $20,000 for the year of donation, being the amount of $100,000 in excess of the annuity payments of $80,000	• the donor receives a tax receipt of $50,000 for the year of donation, being the amount of $100,000 in excess of the $50,000 cost to provide the annuity
• All of the $80,000 annuity payments are tax free	• $30,000 of the $80,000 annuity payments will be included as income of the donor over 8 years, with the balance of the $50,000 to be tax free

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- However, CRA indicated that the administrative policy set out in IT-111R2 will continue to apply to annuities that were issued prior to December 21, 2002.
- The expectation of CRA that, notwithstanding the withdrawal of this administrative policy, "charitable annuities are likely to continue as a means of fund raising, and may well be more advantageous to the donor" remains to be seen

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4. New Definition of Charitable Organizations and Public Foundations

- In the December 2002 draft amendment, the definitions of charitable organizations and public foundations were amended by replacing the "contribution" test with a "control" test
- The rationale for amending the definitions is to permit charitable organizations and public foundations to receive large gifts from donors without concern that they may be deemed to be a private foundation

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- The previous "contribution" test meant that where more than 50% of the capital of a charity was contributed from one donor or donor group then the charity would be deemed to be a private foundation subject to more stringent activity and disbursement requirements
- The new "control" test means that while a donor may donate more than 50% of the capital of a charity, the donor or donor group cannot exercise control directly or indirectly in any manner over the charity or be in a non arms length relationship with 50% or more of the directors or trustees of the charity

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- **As a result of the introduction of a "control" test, the convoluted business rules in relation to "control" will become applicable as a result of the phrase "controlled directly or indirectly in any manner whatever"**
- **Charities will now need to be careful that they do not unwittingly become designated as a private foundation instead of either a charitable organization or public foundation**

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5. The Evolving Shutdown of Tax Shelter Donation Programs

- **A tax shelter is defined under the *Income Tax Act* as any property for which a promotion represents that an investor can claim deductions or credits which equal or exceed the actual amount of the investment within four years of its purchase**
- **The definition of tax shelter was amended in the February 2003 Budget to include tax credits on charitable donations and limited recourse debt**
- **This meant that tax shelter donation programs with promises of net return on investments needed to be registered as tax shelters**

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- **The potential misuse of tax shelter donation programs continued to be scrutinized by CRA and were not limited to only "art flips"**
- **The position of CRA was set out in a CRA Fact Sheet entitled "Art-Donation Schemes or 'Art-Flipping'". The mechanism commonly utilized in these schemes is explained as follows:**
  - **Step 1: A promoter gives a person the opportunity to purchase one or more works of art or another item of speculative value at a relatively low price and works with the person in donating the items to a Canadian registered charity**

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- Step 2: The person donates the art or other item and receives a tax receipt from the charity that is based on an appraisal arranged by the promoter that is substantially higher than fair market value
- Step 3: When the person claims the receipt on his or her next tax return, it generates a tax saving that is higher than the amount paid

- These donation programs turn on the fact that the item in question is purchased at a substantially lower price than its much higher fair market value, and that a donation receipt is issued by a registered charity for the fair market value when the item is donated to it

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- CRA provided warnings to charities considering becoming involved in donation tax shelters
  - CRA's Fact Sheet entitled "Canada Customs and Revenue Agency Reminds Investors of Risks Associated with Tax Shelters" stated that registration as a tax shelter "does not indicate that the CRA guarantees an investment or authorizes any resulting tax benefits" and that "CRA uses this identification number later to identify unacceptable tax avoidance arrangements"

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- CRA's Fact Sheet concerning Art-Donation Schemes or 'Art-Flipping' indicated that third party penalty can include charities that receive the donation if "it knows – or if it can reasonably be expected to have known – that the appraised value were incorrect"

- The December 5, 2003 draft amendments to the *Income Tax Act* have in effect shut down tax shelter donation programs by limiting the tax benefits from donations made under tax shelter donation arrangements

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- The proposed amendments set out a three year limit in which property donated in a tax shelter program will be valued at a donor's cost to acquire the property, changing the value of the donations to the actual purchase price of the donated items rather than the appraised value during the three year period
- Excluded are shares in publicly traded companies, real estate, ecological gifts, inventory and cultural properties but shares in privately held companies are caught
- The proposed December 5, 2003 amendments in this regard, if passed, will apply to gifts made on or after December 5, 2003

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- The December 5, 2003 draft amendments also preclude charitable receipts for limited-recourse debt in respect of gifting arrangements
- Limited recourse debt is a form of tax shelter in which the taxpayer incurs a debt for which recourse is limited and which debt can reasonably be considered to be related to a charitable gifting arrangement
- The proposed amendments in relation to limited recourse debt, if passed, will apply to gifts made on or after February 19, 2003

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- Where a charity has been involved in a tax shelter donation scheme prior to the announcement of proposed changes to the ITA provisions on December 5, 2003, the following are some of the issues that the charity will need to consider:
  - Tax shelter registration does not in itself give the donation program any protection
  - Possible difficulties in establishing fair market value of goods donated
  - The onus is on the charity to arrange a qualified appraisal of the donation, not on the promoter or the donor
  - There may be an issue of establishing donative intent by the donor

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- **It is important to determine whether the donations are gifts of capital or inventory**
- **Possible third party penalties levied against a charity for improper valuation of the fair market value of items donated**
- **Potential assessment challenges of donors by CRA with possible claims over against the charity**
- **Potential problems in complying with a charity's disbursement quota**
- **Due diligence requirements on the part of the charity in receiving, monitoring and disbursing products that were donated**

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- **Did the charity obtain independent legal advice**
- **Where a legal defence fund was promised, questions of sufficiency need to be considered and whether it is available for the benefit of the charity as opposed to donors**
- **Possible loss of charitable status by the charity**
- **Possible exposure of directors to personal liability to donors who are reassessed**

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6. Revocation of Registration of Charities

- **Pursuant to the proposed December 2002 Amendments, subsection 149.1(2), (3) and (4) will be amended to permit the revocation of the charitable status if a charity "*makes a disbursement by way of a gift*" which is not a gift made "*in the course of charitable activities carried on by it*" or not a gift "*to a donee that is a qualified donee*" at the time of the gift**
- **All gifts made by a charity must be made in the course of furthering its charitable activities or transferred only to qualified donees**

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C. SELECTED DISCUSSION OF NEW POLICIES FROM CRA AFFECTING CHARITIES

1. New Policy Statement on Political Activities

- **The courts have held that an organization that has been established for a political purpose cannot be a registered charity. Political purposes have been defined by the courts as purposes seeking to:**
  - **Further the interests of a particular political party; or support a political party or candidate for public office;**
  - **Retain, oppose, or change the law, policy or decision of any level of government in Canada or a foreign country**

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- **A charity's ability to participate in political activities have been controversial and highly confusing for a long time**
- **CRA's Policy Statement on Political Activities gives clarification to charities from a administrative, not legislative standpoint**
- **The Policy Statement gives a broader interpretation of what are charitable activities as opposed to political activities**
- **CRA has established three categories of involvement by charities in political activities:**
  - **Charitable activities**
  - **Prohibited activities**
  - **Permitted political activities**

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- **Examples of charitable activities:**
  - **Distributing the charity's research on a particular topic relevant to its charitable purpose**
  - **Releasing and distributing a research report to election candidates**
  - **Publishing a research report online**
- **Examples of prohibited activities:**
  - **Supporting an election candidate in the charity's newsletter**
  - **Distributing pamphlets that underline the government's lack of contribution to the charity's goals**
  - **Preparing dinner for campaign organizers of a political party**
  - **Inviting competing election candidates to speak at separate events**

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- Examples of permitted political activities:
  - Buying a newspaper advertisement to pressure the government
  - Organizing a march to Parliament Hill
  - Organizing a conference to support the charity's opinion
- Limits on using charitable resources for permitted political activities:
  - Under the ITA, a charity must devote substantially all of its resources to charitable activities
  - Substantially "all" is defined by the CRA as 90% or more, meaning that a charity may not devote more than 10% of its total resources per year to political activities

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- Smaller charities with less than $50,000 annual income can devote up to 20% of their resources to political activities; income between $50,000 and $100,000 can devote up to 15%, and income between $100,000 and $200,000 can devote up to 12%
- Resources used towards permitted political activities are not applied to meeting a charity's disbursement quota for receipted donations

2. New Policy on Business Activities

- See separate presentation by Adam Parachin

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3. CRA Summary Policy on Ten Year Gifts

- A ten-year gift is a donation that is made subject to a donor's written trust or direction that the gift be held by a registered charity for 10 years or more
- A ten-year gift is excluded from the disbursement quota
- However, when a 10-year gift is eventually spent, it must be included in calculating the disbursement quota
- CRA will need to clarify its position on what happens to inclusion in the disbursement quota when the ten year gift or a part of it is disbursed during the ten years

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4. New Policy on Donation of Gift Certificates

- **CRA has outlined a number of situations under which a charity may issue an official donation receipt for the donation of a gift certificate, including:**
  - **Where the donor purchases or obtains the gift certificate directly**
  - **Where the issuer of the gift certificate directly donates a gift certificate to the charity, and the charity, not a third party, redeems the certificate for property**

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5. New Policy on Holding of Property for Charities

- **CRA has recognized that organizations that hold title for registered charities can be registered as charities themselves**
- **Charities may want to use charitable title-holding organizations in order to protect their assets from liability associated with operation**
- **Examples would be separate foundations for:**
  - **Land holdings**
  - **Equipment and/or management facilities**
  - **Licensing of Intellectual Property**

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6. New Policy on Third Party Fundraisers

- **A charity can use a third party organization or fundraiser as an agent to organize a fundraising event**
- **However, the fundraiser, as agent, is responsible to the charity as principle and the charity is liable for the actions of the agent**
- **Therefore, a charity must retain control over all monies earned and all receipts issued in relation to a fundraising event**

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7. **Policy Commentary on Charities Managing Investment Portfolios**

- **Clarifies whether or not a private foundation's management of an investment portfolio constitutes a business activity**
- **Private foundations are prohibited from involvement in any business activity**
- **However, managing one's own investment portfolio is not automatically considered a business activity, but a case-by-case analysis must be done**
- **The position of CRA is that registered charities can manage the investment portfolios of other registered charities at below market rates**

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- **However this position does not address the problem of delegation and sub-delegation at common law**

8. **Summary Policies**

- **Examples of more than 28 Summary Policies affecting charities include:**
  - **Fundraiser**
  - **Religion**
  - **Broad & vague objects**
  - **Restricted funds**
  - **Confidentiality**
  - **Directors/trustees**
  - **Conditional gift**
  - **Designated gift**

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D. OTHER NEW DEVELOPMENTS AFFECTING CHARITIES

- **Information returns submitted by charities are now available on-line, save and except for any portions of the return designated as confidential**
- **CRA will now automatically calculate the disbursement quota for a charity from the T3010**
- **The board of directors of a charity is advised to ensure the accuracy of reporting when completing the new shorter T3010A returns and to verify the records on-line to ensure that the information available to the public is correct**

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Charitable Gifting:
Issues for Donors and the Charity

M. Elena Hoffstein
February 10, 2004

Overview

A. Definitions
   1. Charitable organizations, foundations (public & private)
   2. Disbursement quota
B. Disbursement Quota: Importance
C. Disbursement Quota for Organizations and Foundations
D. Inter Charity Gifts
E. Ten Year Gifts
F. Satisfying the Disbursement Quota
G. Frequently Asked Questions

A. Definitions (1)

- Charitable Organization
  - all resources devoted to own charitable activities
  - more than 50% of directors, officers, trustees deal at arms length
- Charitable Foundation
  - operated exclusively for charitable purposes
  - generally act as conduits for distributing funds to charitable organizations
  - can be public or private
  - public foundation: where more than 50% of directors, trustees, officers deal at arms' length

A. Definitions (2)

- Changes in December 2002 “contribution” test with “control” test in respect of charitable organizations and public foundations
- Rationale: to allow such charities to receive large donations without concern they may be characterized as private foundation with more stringent controls on activities and disbursement requirements
- Previous Test: where more than 50% of capital contributed by one donor, charity was classified as private foundation
- New Test: even if more than 50% of capital contributed by one donor so long as donor or donor group does not control the charity, it can still remain characterized as a public foundation

A. Definitions (3)

- What is the Disbursement Quota?
  - A prescribed amount a registered charity is required to disburse annually to maintain charitable status
- Purpose
  - to ensure charities use charitable funds on charitable activities/purposes
  - to discourage charities from spending excessive amounts on fundraising and from accumulating excessive funds.
- Different disbursement quota for the 3 categories of charities: charitable organizations, public foundations, private foundations

B. Disbursement Quota: Importance

- Important for Donors and Donees
- Nature of property gifted
- Nature of restrictions imposed
- Source of gift

C. Disbursement Quota for Organizations and Foundations

- Organizations: 80% of receipted donations of prior year
  - Exceptions:
    - (i) Gifts of capital under a will
    - (ii) Gifts subject to trust or direction to hold gift or property substituted therefor for at least 10 years
    - (iii) Gifts from other charities
    - (iv) 80% of amounts previously excluded under (i) and (ii) but which are spent in the year
- Foundations:
  - Same rule re 80% (except for gifts from other charities) + 4.5% of the average value of investment property

NOTE: receipt if life insurance proceed does not appear to be caught by disbursement quota obligations

D. Inter Charity Gifts

- Gifts to charitable organization: not subject to DQ of organization
- Gifts to Foundation: Foundation must disburse 80% (Public) or 100% (Private) irrespective of whether receipt issued
- Exception:
  - Specified gifts

When Does the Issue Arise?

- Donor wishes to satisfy charitable pledge by gift from private foundation to public foundation
- Private Foundation wishes to wind up and transfer its property to community foundation
- Organization wants to set up parallel foundation for asset protection purposes

Specified Gifts

- Gifts from one charity to another designated by donor charity as a specified gift will not count toward satisfaction of DQ of donor charity
- Donee charity does not have to include amount of gift in its DQ
- Important for donee Foundation to make inquiries
- Also important for Organizations to ask because specified gifts not included in income of organizations which can't disburse more than 50% of their income to qualified donees
- Inter-charity transfers of 10 year gifts also problematic

E. 10 Year Gifts

- CCRA documentary requirements
- Trust or direction
- Disbursement quota issues
  - if encroach on capital during 10 year hold period
  - if encroach on capital after 10 year period
  - 4.5% disbursement quota still applies
- Capital gains not considered "income"
- Inter charity transfers of 10 year gifts
- Low investment returns

F. Expenditures Which Count Toward Satisfaction of Disbursement Quota

(i) funds expended by charity on own charitable activities or

(ii)disbursed to qualified donees

- registered charities
- registered Canadian amateur athletic associations
- housing corporations
- UN and its agencies
- foreign universities - Schedule VIII
- agent crowns
- registered national arts associations

Funds Expended Directly on Own Charitable Activities

- Includes salaries of those performing the charitable work and disbursements for equipment used in charitable activity
- Does not include amounts spent on management, general administration and fund raising (Information Circular 80-10R)
- Can use "agents" so long as guidelines are followed

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Funds Expended Directly on Own Charitable Activities (cont'd)

- Generally gifts to foreign charities not permitted unless on Schedule VIII or disbursement by Canadian charity to foreign entity as its agent or under contractual arrangement or as part of a joint venture arrangement
- In these latter cases, Canadian charity is carrying out its own activities using services of foreign entity.

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G. Frequently Asked Questions

- Can charity disburse funds to an entity that does not constitute a qualified donee once its DQ is met?
- What if DQ is exceeded in a particular year?
  - Carry forward up to 5 years or back 1 year
- What if DQ is not met in a particular year?
  - Revocation
  - apply excess from prior years
  - ask to reduce DQ

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G. Frequently Asked Questions (cont'd)

- Can a charity accumulate funds for large scale projects and still meet its DQ?
  - Apply for permission to accumulate
  - encourage making of bequests
  - life insurance - does not appear to be included in disbursement quota

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HOSPITALS AND FOUNDATIONS SERIES:
Healthcare Philanthropy: Challenges and Solutions
February 10, 2004

Policy Based Board Governance: What Works and What Doesn't

By Donald Bourgeois, B.A., LL.B.

Introduction

- Define "policy governance" and administrative governance"
- Review standards of care for directors and officers
- Examine factors for boards of directors to take into account in determining governance approach
- Review policies that ought to be in place for most organizations

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What is Governance

- "Governance" is a combination of both overall processes and the structures that are used in directing and managing the organization's operations and activities
- "Stewardship" is the responsibility of the board of directors and involves the active oversight by the board of the organization's governance
- Two conceptual approaches to "governance" and "stewardship"

3

Administrative Governance Model

- **"Traditional approach"**
- **Board makes most substantive decisions based on materials and discussion at board meeting**

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Policy Governance Model

- **Board has "oversight" role rather than active role in managing affairs of the organization**
- **Approach relies more on development of operational policies implemented by staff and officers**

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Reality

- **Most organizations will – and should – operate on the basis of a mixture of the two models**
- **Spectrum between "administrative governance" and "policy governance" based on several factors**
  - **Legal authority of directors, officers and organization itself**
  - **Statutory or common law obligations or restrictions or contractual obligations**
  - **Constating documents**

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– Culture of organization
– Views and perspectives of key stakeholders
– Skills, competence and training of staff and volunteers
– Resources
– Size and type of operation
– Activities carried out by the organization
– Due diligence requirements of the directors and officers

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Carver "Policy Governance"

- Variation or different type of governance model
- Assumes board of directors represents "interests of the owners" – difficult concept to implement, especially in charitable sector
- Ends/Means distinction

  If the board has established Ends and has determined through monitoring that these Ends are actually accomplished, it can be argued that the staff Means must have worked

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- Categories of Policy (Carver)
  - Ends
  - Executive Limitations
  - Governance Policy
  - Board/Staff Linkages

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Duty of Directors and Officers

- Duty to manage the affairs of the organization – statutory and common law duty
- No clear articulation of what is meant by "manage the affairs" – but more than monitoring

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- Panel on Accountability and Governance in the Voluntary Sector
  - Mission and Strategic Planning
  - Transparency and Communication
  - Organizational Structures
  - Board's Understanding of its Role
  - Fiscal Responsibility
  - Oversight of Human Resources (staff and volunteers)
  - Assessment and Control Systems
  - Planning for Succession and Diversity

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Duties of Directors

Case law

- Fiduciary relationship (corporate law)
  - To act with a reasonable degree of prudence
  - To be diligent
  - To act in good faith, honestly and loyally
  - To avoid conflicts of interest

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- Trustee or "Akin-to-Trustee" (charitable law)
  - To exercise vigilance, prudence and sagacity
  - To act in good faith
  - Duty not to delegate
  - Duty not to have conflict of interest

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- Public Guardian and Trustee
  - To be reasonable, prudent and judicious
  - To carry out the charitable purposes
  - To avoid conflicts of interests
  - To act gratuitously
  - To account
  - To manage the charity's assets

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Duties of Directors
Statutes

- Employees and the workplace
- Taxation and other imposts
- Environmental
- Business practices
- Competition
- Information and personal privacy
- Intellectual property
- Vulnerable clients

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Standards of Care

- Statutes, common law and contracts impose duties on directors and set out standards of care on directors
- Potential for personal liability if the applicable "standard of care" is not met
- No clear "standard of care" or single standard of care that is applicable in all circumstances
  - May vary by statutory duty
  - May vary based on individual background, training and experience

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- May vary by type of activity
- May vary by legal status of organization – trust, unincorporated association, corporation, statutory corporation
- May vary as between "not-for-profit" and charitable (trustee or "akin to trustee")

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Standard of Care – Objective or Subjective?

- *Re City Equitable Fire Insurance Co.* – early 20th century

  Degree of skill required in what "may reasonably be expected from a person of his knowledge and experience"

- Subjective, not an objective standard of care

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- ***Canada v. Corsano*** **– late 20th century with statutory standard of care**

All directors of all companies are liable for their failure if they do not meet the single standard of care provided for in subsection 227.1(3) of the Act. The flexibility is in the application of the standard of care since the qualification, skills and attributes of a director will vary from case to case. So will the circumstances leading to and surrounding the failure to hold and remit the sums due

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Standard of Care – Charitable Organizations

- ***Re Public Trustee and Toronto Humane Society et al.***

Whether one calls them trustees in the pure sense (and it would be a blessing if for a moment one could get away from the problems of terminology), the directors are undoubtedly under a fiduciary obligation to the Society and the Society is dealing with funds solicited or otherwise obtained from the public for charitable purposes. If such persons are to pay themselves, it seems to me only proper that it should be upon the terms upon which a trustee can obtain remuneration, either by express provision in the trust document or by the order of the court

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- ***Charities Accounting Act***
- ***Asian Outreach Canada v. Hutchinson***

The confusion has sometimes arisen is a consequence of the fact that the equitable jurisdiction of the Court includes both the enforcement of trusts and the supervision of charities whether the latter are established under will or trust instruments inter vivos, or as corporations. As many of the general principles applied by the courts in supervising charitable trusts have also been applied to charitable corporations there was tendency, particularly in 19th Century cases in England, to find the basis of the jurisdiction over charities in the law of trusts. This does not appear to be correct historically and it is clear that it does not represent the present state of the law in this jurisdiction

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- Confusion over "standard of care", especially for directors and officers of charitable organizations
- Directors need to be prudent in deciding upon governance approach and to be able to defend that choice

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What is "Policy"

- A policy is a governing principle. It allows the board to delegate to others (staff, volunteers, agents) the authority to act on behalf of the organization
- Board control over the implementation of a policy is essential
- Policy allows staff, volunteers, agents and others to know what the board wants and expects and why

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- Policy is intended
  – To bring a reasoned approach to a particular matter or issue
  – To provide for consistency and overall fairness and predictability to decisions
  – To encourage full consideration of all relevant factors before a decision is made on the merits of a particular matter
  – To carve out areas of specific responsibility and accountability so that those who know the job best are the ones who have the responsibility to do it

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What Types of Policies Are Common?

- **Governance Policies**
  - **Letter patent, memorandum of association, trust deed or similar constating documents**
  - **By-laws**
  - **Board structure and decision-making processes (e.g. committees)**
  - **Rules of procedures or rules of orders**
  - **Conflict of interest policy**
  - **Communications policy**
  - **Access to information and protection of privacy policy**

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- **Strategic Planning**
  - **Mission statement**
  - **Statement of goals and objectives**
  - **Business plans**
  - **Budgets and resource allocations**

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- **Operational Policies**
  - **Financial management (cash management, internal procedures, banking arrangements, internal audit)**
  - **Compliance management**
  - **Human resource management (management, staff, volunteers)**
  - **Program management**

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Policy Process

- **Identification of need for a policy – experience, legal requirement (e.g., *Occupational Health and Safety Act, Trustee Act)***
- **Terms of reference for policy development, format and research**
- **Review of legal requirements and standards that are applicable**
- **Drafting a policy**
- **Discussion of draft policy and preparation of final version**

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- **Approval by the board**
- **Development of implementation plan**
- **Approval of the implementation plan, which may require resource allocation**
- **Evaluation of policy and its effectiveness**
- **Revision of policy**

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Selected Policy Documents

- **Conflict of Interest**
- **Code of Conduct**
- **Personal information and Privacy**
- **Human Resource and Workplace Policies – occupational health and safety, harassment and discrimination, hiring and retention**
- **Financial Management and Overview**
- **Regulatory Compliance Management**

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- Asset Protection – insurance and indemnification (officers and directors, general liability, professional or other activity/client specific insurance)
- Fiscal Management
- Program Review
- Investment Policy (charitable property)
- Program Policies

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Conclusion

- Most organizations will have "policies" in place that are used by the board and/or staff to guide decision-making
- The degree to which policies are required will vary depending upon type of organization, its size and operations, its resources, statutory or contractual obligations
- Board of directors, regardless, must "manage the affairs" of the organization and cannot simply delegate to others

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Estate Administration Issues with Charitable Gifts

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February 10, 2004

Estate Administration Issues with Charitable Gifts

- Estate administration
  - with a will
  - without a will
- Focus: administration of estate with a will
- Probate of will: is it necessary?
  - If executors named but unwilling or unable to act
  - Nature of assets may require probate (land in land title system)
  - Even if not legally required may be required, from a practical point of view (publicly traded shares, bank accounts, etc.)

Notice

- If will probated:
  - notice of application for Certificate of Appointment of Estate Trustee sent to beneficiaries
- If will not probated:
  - obligation of Estate Trustee to notify beneficiaries
- Charitable beneficiary may have prior notice (from testator) or may have copy of will
- If so, check records against notice given by Estate Trustee

Responsibilities of Charity

- Answerable for its activities and for use and disposition of its property
- Subject to jurisdiction of court and provisions of certain statutes (*Trustee Act*, *Charitable Gifts Act*, *Charities Accounting Act*)
- Need to be aware of nature and extent of potential gift
- Gift may be (i) a cash bequest or (ii) a gift of an asset such as land, building, art, artifact or(iii) a residual interest and may have no restrictions or may be subject of conditions & restrictions in use of gift, investment etc.

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Process

- Open file
  - Note relevant information; obtain copy of will and review charitable gift provisions
  - Type of gift
- Conditions attaching to gift
  - Subject to prior life interest
  - Conditions/restrictions in use of Income /Capital
  - Conditions/restrictions in object/purpose of gift
  - Investment restrictions

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Process (cont'd)

- Is gift acceptable:
  - Are constraints against public policy or otherwise not within objects of the charity
  - Is nature of the gift acceptable (ex land/buildings etc.)

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Monetary Gift

- Executor's year: Estate Trustee cannot be compelled to pay legacy before first anniversary of death even if will so provides
- Interest will be payable if delay in payment beyond first anniversary
- Value of estate may be reduced by liabilities; taxes; costs of administration; spousal/dependant relief/quantum meruit claims and other claims
- If estate not large enough to pay legacies they may have to abate rateably

Personal Property/Gift of a Specific Asset

- Charity needs to consider if it wishes to accept the gift
  - some gifts are "Trojan horses"
    1. Land, buildings
      - contaminated land
      - building that needs extensive repair
      - may not be saleable
      - real property that charity can't manage
      - effect of *Charities Accounting Act;* 3-year restriction on property not used in charitable activity

Personal Property/Gift of a Specific Asset (cont'd)

- "Trojan horse" gifts - cont'd
  2. private company shares
     - can they be redeemed?
     - Charity can't own more than 10% of a business for more than 7 years & if it owns more than 50%, then reporting requirements to P.G.T.
- valuation of gift; charity must determine
- timing of charity receipt (effect of prior life interest)
- costs of delivery (does estate or charity pay?)

Residual Interest

- Will necessitate more active role in reviewing the administration of the estate
- Need regular reporting and accounting
- Query if partial distribution is possible pending finalizing the administration
- Be aware of timelines … patience is key. Filing and processing of tax returns and clearance certificate requests take time
- Will be requested to sign release and indemnity

Estate Accounting

- Estate trustee has obligation to maintain proper accounts
- Beneficiary has right to inspect the accounts including inspection of vouchers
- Capacitated beneficiaries can approve accounts
- If minor or incapable beneficiaries accounts must be passed in court
- Estate Trustee can voluntarily pass accounts or can be compelled to so do

Form of Accounts

- Original Assets
- Revenue
  - receipts
  - disbursements
- Capital
  - receipts
  - disbursements
- Investments
- Assets on hand at end of accounting period

Timing of Passing of Accounts

- If estate is distributable and not complicated, accounting generally occurs towards end of administration. May be two part accounting: main accounting and final wind up accounting for holdbacks
- If estate more complex or longer administration, first accounting may be at end of a period of accounting and thereafter at regular intervals … every 3-5 years is common length of accounting period.

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Due Diligence by Charity Beneficiary

- Charity has obligation to scrutinize the accounts
- In the past Public Guardian and Trustee could be relied on to act as watchdog
- Current position of PGT is that charities:
  - are sui juris, legally competent to protect their charitable interests
  - have a fiduciary duty to do so
  - are accountable to protect this interest and may be held liable for failure to do so

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Factors to Consider

- Check investments (was even hand maintained)
- Check payments on both Revenue and Capital side Are they reasonable?
- Check performance of portfolio, check proceeds received on disposition of assets with value of asset at date of death (were there capital gains or losses?)
- Is estate holding wasting assets (ex cottage property which produces little to no income but may require disbursements) if so how are disbursements allocated

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Special Considerations

1. Compensation

- Fee Agreements
- Terms of will
- Trustee Act "fair and reasonable allowance"
  - mathematical formula: customary rate
  - factors developed in case law include complexity of estate administration, difficulties arising in the administration, size of estate etc
  - care and management fee and sometimes a special fee may be justified
- Pre-taking of compensation
  - generally pretaking is not allowed
  - some softening of this position in recent cases … if reasonable and within range normally allowed by court.

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Special Considerations

2. Legal/Accounting and Other Professional Fees

- "Double dipping" : is Estate Trustee claiming compensation for work he/she retained professionals to do (ex accounting)
- Courts have allowed estate trustees to pay for investment counsel and real estate agent fees
- Charity beneficiary can ask for copies of detailed bills and can challenge professional fees even if already paid

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Special Considerations

3. Taxes

- Charitable gifts can have maximum tax benefit in year of death and immediately prior year - tax credit can be applied against 100% of income in year of death & immediately preceding year
- Charity beneficiary should check if Estate Trustee maximized charity tax credit. If intervening life interest, charity credit may still be claimed in year of death so long as no right to encroach on capital during life interest
- Charity receipt cannot be issued until gift is received. However charity tax credit can still be claimed in terminal return

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Releases and Indemnity

- Release is desired by Estate Trustee to protect him/her. It binds the beneficiary's acceptance of the administration of the estate
- If charity beneficiary is a recipient of money or property, should only sign a document acknowledging receipt of the gift and that it represents full satisfaction of what the charity is entitled to under the will
- If charity beneficiary is a residual beneficiary will likely be asked to sign a release and indemnity. Indemnity generally provides that the charity agrees that if in the future the Estate Trustee determines there are further estate liabilities and no estate assets left in the hands of the Estate Trustee, the charity beneficiary will reimburse the Estate Trustee for that liability.

Releases and Indemnity (cont'd)

- Should try to clarify the nature and extent of the potential liability the Estate Trustee is concerned about
- If concern is income tax liability, perhaps delay the distribution of the estate or increase the holdback amount until the Clearance Certificates are received
- Charity could also try to limit the quantum of the indemnity to the amount received by the charity
- Charity can't sign indemnity for money or cause of action beyond what estate would otherwise be liable for

Estate Litigation

- Arise as result of disputes surrounding the making of the will (undue influence, lack of testamentary capacity, improper execution) or interpretation of the will, disputes between classes of beneficiaries or between beneficiaries and estate trustees or claims by third parties (spouses, dependants, creditors etc)
- Will challenges Effect may be to void the will and estate will be distributed as on intestacy (no charity interest on intestacy) or may bring forward a prior will where charitable interest may be more or less than in contested will

Estate Litigation (cont'd)

- Involvement of charity will depend on a number of factors:
  - size of charity,
  - public relations,
  - access to advisors.
- Costs can be saved if several charity beneficiaries with similar interests could retain one solicitor
- Alternately could submit rights to court.
  - i.e leave battle to others without losing right to participate in settlement
- Charity may be asked to renounce testamentary gift, for example, in family hardship situations. Charity has fiduciary obligation to pursue testamentary gifts. No legal authority for charity to unilaterally renounce a gift.

Cy Pres Applications

- Unique application relating to charitable gifts allows charity to seek advice and direction of court in circumstances where charity misnamed or misidentified or to clarify purpose of gift that is impossible or impractical to administer
- Court will try to uphold charitable gift intentions where possible but to do so must find that deceased had general charitable intent
- Types of cy-pres applications
  - where charity named is non existent and never existed
  - where charity named in will has transferred its assets and operations to another charity or charity named has merged its operations with another charity
  - where the extent of the gift is not clearly spelled out in the will
  - where terms of the gift are contrary to public policy

Cy Pres Applications (cont'd)

- Court has inherent scheme approval power to modify terms of a gift.
  - where limitation is too precise
  - to modify administrative terms of a charitable trust in order to further its charitable objects (Killam estate)
- If court will not invoke its authority, gift might fail and the property reverts to estate to be distributed in accordance with the will
- Of interest to hospitals and foundations will be the Re Baker case. Testamentary gift to Northwestern General Hospital. Hospital incorporated a foundation after death of testator for purpose of holding funds for advancement of medical research and education. Estate trustee sought permission of court to transfer estate funds to the foundation and court refused to invoke its jurisdiction.

What Should Testamentary Charity Beneficiary Do?

- Have process in place for testamentary gifts which should include the following:
  - receipt and review of will,
  - documentation of nature of gift, conditions/restrictions applicable to gift,
  - restrictions may relate to
    - (a) purpose of gift
    - (b) investment powers
    - (c) use of capital
    - (d) commingling with other gifts
  - check if condition precedent or condition subsequent
  - check if cy-pres language
  - have tickle system to bring forward the file at appropriate intervals

What Should Testamentary Charity Beneficiary Do? (cont'd)

- Prepare precedent documents . For example could craft own form of release to present to Estate Trustees rather than use theirs.
- Designate a person in the charity to monitor testamentary gifts This will achieve consistency, knowledge and experience for the charity
- Don't forget the public relations aspects of the gift. Write to the family to express appreciation for the gift.
- Have appropriate fundraising materials clarifying preferred language for testamentary gifts (both restricted and unrestricted)

HOSPITALS AND FOUNDATIONS SERIES
Healthcare Philanthropy: Challenges and Solutions
February 10, 2004

How to Avoid Liability In Fundraising

By Terrance S. Carter, B.A., LL.B.

Overview

- Legal Responsibility of Charities and Directors in Fundraising
- Fundamental Legal Considerations Involved in Fundraising
- Donor's Rights and Remedies in Fundraising
- Avoiding Liability in Fundraising Involving Testamentary Gifts
- Avoiding Liability Involving Donor Restricted Charitable Gifts
- Avoiding Liability in Gift and Fundraising Programs

2

Legal Responsibility of Charities and Directors in Fundraising

- Improper or negligent actions by development officers or fundraisers may expose a charity and its directors to legal liability
- The court held in *The Aids Society for Children* (Ontario) that
  - Although a charity does not hold its charitable property in trust for its charitable purpose, a charity has a fiduciary obligation to apply donations for its charitable purposes

3

- A fiduciary has a legal obligation to put the interests of others ahead of the interests of the fiduciary
- There is little practical distinction for directors between being a trustee and having fiduciary obligations
- A charity and its directors have a fiduciary obligation to account to the public for all funds raised from donors
- Charities and directors therefore have a fiduciary obligation to donors to ensure that donations are applied for the charitable purposes of the charity

4

- It is essential for charities and their directors to review charitable objects on a regular basis and amend those objects as necessary
- Third party fundraisers and subcontractors are agents of the charity and may cause liability for both the charity and its board of directors personally
- Fundraising contracts which provide for unreasonable compensation may be voidable based upon both violation of public policy and/or misrepresentation

5

- Misrepresentation is determined by the perception of the donor, not by the intent of the charity or its directors in receiving the gifts
- The fiduciary duty of a charity and its board of directors to account for donations applies to the gross amount of donations raised by third party fundraisers, not to the net amount that the charity may be entitled to pursuant to a fundraising contract
- Fundraising costs of between 70% to 80% rendered the contracts void as being contrary to public policy

6

- The directors were found personally liable for unreasonable fundraising costs in the amount of $766,000
- Fundraising companies were required to repay unreasonable fundraising costs
- The directors were subjected to a penalty of $50,000.00 under the *Charities Accounting Act* (Ontario)

- The court in *National Society for Abused Women and Children* confirmed
  - Fiduciary obligation of directors to account for unconscionable fundraising costs

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- Fundraising contract was declared void *abinitio* as being contrary to public policy
- Donors are entitled to know about fundraising and administrative costs when making donations

- For more information on these cases, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca
- The "buck" stops with the board of directors of a charity after everyone else has left the charity
- The board of directors must therefore be made familiar with all fundraising programs and the liabilities that are associated with those programs

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Fundamental Legal Considerations Involved In Fundraising

- Fundraising is not an end in itself
- Fundraising must comply with the applicable corporate objects and powers of the charity
  - The fundraising program must not be *ultra vires* the charitable objects of the charity
  - The charitable purpose being furthered by fundraising must not be *ultra vires* the charitable objects
  - A donor restricted gift resulting from fundraising must not be *ultra vires* the charitable objects

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- **Fundraising must not violate applicable statutory provisions**
  - **Specific charitable statutes affecting fundraising**
    - ***Charities Accounting Act* (Ontario) and applicable regulations**
    - ***Charitable Gifts Act* (Ontario)**
    - ***Religious Organizations Land Act* (Ontario)**
    - ***Income Tax Act* (Canada)**
      - **Exposure to civil penalties for misrepresentation of tax matters by third parties**

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- ***Charitable Fund-raising Act* (Alberta)**
- ***The Charities Endorsement Act* (Manitoba)**
- ***Charities Act* (PEI)**
- ***Charitable Fund-raising Businesses Act* (Saskatchewan)**
- ***Anti-terrorism Act* (Canada)**
- ***Taxation Act* (Quebec)**

– **Uniform Law Reform Commission is expected to standardize fundraising legislation across Canada**

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- **General statutes affecting charitable fundraising**
  - ***Trustee Act* (Ontario)**
  - ***Securities Act* (Ontario)**
  - ***Insurance Act* (Ontario)**
  - ***Loan and Trust Corporations Act* (Ontario)**
  - ***Competition Act* (Canada)**
  - ***Privacy Act (PIPEDA)* (Canada)**
  - **Provincial Privacy Legislation**

- **Fundraising must not involve gifts that are contrary to public policy**
  - **Charitable gifts involving discrimination**
  - **Charitable gifts involving illegal activities**

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Donor's Rights And Remedies In Fundraising

- **General exposure to liability involving donors**
  - **Misrepresentation involving issuance of charitable receipts and/or the amount**
  - **Failure to comply with donor restrictions**
  - **Failure to disclose excessive fundraising costs**
  - **Detrimental reliance upon charitable endorsements**
  - **Detrimental reliance upon improper tax advice involving donations**
  - **Breach of fiduciary duty and/or breach of trust in applying funds to charitable purposes**

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- **Donor's statutory rights**
  - ***Charities Accounting Act* (Ontario)**
    - **Section 6 of the CAA (public inquiry)**
    - **Section 10 of the CAA (alleged breach of trust)**
    - **Section 4(d) of the CAA (noncompliance with donor directions)**
    - **Section 3 of the CAA (formal passing of accounts)**
  - **The *Income Tax Act* (Canada)**
    - **Informal complaint to CCRA**
    - **Resulting audits**
    - **Receipting and disbursement violations**

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Avoiding Liability in Fundraising Involving Testamentary Gifts

- **Reducing legal risks from estate planning programs**
  - **Shift the legal risk away from the charity**
    - **Download the risk to professionals, i.e. accountants or lawyers, to establish evidence of due diligence**
    - **Raise the shield of liability insurance whenever possible, if available**
    - **Return any original wills or codicils to donors or their lawyers**

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- Avoid circumstances conducive to allegations of undue influence
  - Directing work to a particular lawyer
  - Paying for a portion of donor's legal costs
  - Acting as either an estate trustee (executor) or attorney under a power of attorney
  - Preparing a will or power of attorney
  - Providing advice on how to structure disposition clauses in a will
  - Providing recommendations on how much of the estate should be given to a charity or charities in general

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- Completing the will guide on behalf of the testator instead of only assisting with background information
- Meeting with the lawyer when the donor gives instructions for the will
- Being present when the will is being signed
- Offering to store the original will, codicil to a will, or power of attorney

- Managing testamentary gifts
  - Ensure that a copy of the will is received and carefully review charitable gift provisions
  - Review any applicable donor restrictions before agreeing to receive the gift

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- Require progress reports on the administration of an estate
- Request the distribution of gifts to the estate at the earliest opportunity
- Have legal counsel review estate releases as the charity cannot sign an indemnity for money or cause of action beyond what the estate would have otherwise been liable for
- Have legal counsel review estate accounts before signing estate releases
- Review appropriateness of investments
- Ensure that tax credits are used against 100% of income in the year of death and carried back one year, if necessary

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- Make sure that only duly authorized signing officers execute the releases

- Resist voluntarily renouncement of a charitable gift
  - A charity may be asked to renounce a testamentary gift in situations of financial hardship involving family members of the deceased
  - There is no legal authority for a charity to unilaterally renounce a gift
  - Even court authorization for a renunciation of a testamentary gift is unlikely
  - The charity therefore has a fiduciary obligation to pursue testamentary gifts

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Avoiding Liability Involving Donor Restricted Charitable Gifts

- The difference between unrestricted and donor restricted charitable gifts
  - What is an unrestricted charitable gift?
    - An unrestricted charitable gift is a gift to the charity that is not subject to any restrictions or limitations
  - What is a donor restricted charitable gift?
    - A donor restricted charitable gift that is a gift subject to binding restrictions, conditions or limitations

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- Instances of breach of trust involving donor restricted charitable gifts
  - Diverting a fund to another application
  - Withholding a fund
  - Pooling restricted funds with funds of another donor
  - Encroaching on the capital of an endowment fund
  - Altering the terms of a trust deed
  - Borrowing from a restricted fund
  - Using surplus funds from a fundraising appeal for a different purpose

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- Altering terms of a donor restricted fund without court authorization

- **Can a donor restriction be unilaterally varied?**
  - **Only a court can vary a donor restricted charitable gift on a *cyprés* application**
  - **Exceptions are**
    - **Gift reverting to the donor on a failed *cyprés* application**
    - **Gift reverting to the donor on the failure of either a condition precedent or a condition subsequent**

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- **How should donor restricted gifts be managed once received?**
  - **Identify the nature of the charitable gift**
  - **Review and approve donor restrictions**
  - **Effective ongoing management of donor restricted charitable gifts**
    - **Deposit into the bank account of the named charity**
    - **Invest fund in accordance with applicable investment power**
    - **Do not borrow against restricted fund**
    - **Commingle restricted funds only in accordance with regulations in Ontario and not with general funds**

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- **How can donor restricted charitable gifts be avoided in the first instance?**
  - **Encourage unrestricted gifts**
  - **Alternatively encourage the use of non-binding directions**
  - **Advise donors that all gifts are deemed to be unrestricted unless specifically stated otherwise**

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- **Preventative steps to reduce liability involving donor restricted charitable gifts**
  - **Public fundraising appeals should state that any surplus funds will be used for the general charitable purposes of the charity**
  - **Ensure that donor restricted gift includes a *cyprés* clause that will allow the charity to amend the purpose**
  - **Ensure that documentation creating donor restricted charitable trusts include the words "in trust"**

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- **Protecting donor restricted charitable gifts**
  - **Background of Christian Brothers series of decisions**
  - **Exigibility of special purpose charitable trusts**
  - **Commentary on the *Christian Brothers Ont.* Court of Appeal decision**
    - **Decision is at odds with common law that trust property is not subject to claims against the trustee**
    - **Misunderstanding of what a charitable purpose trust is**
    - **Limited application of the decision provides little comfort**

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- **Impact of the Christian Brothers Ont. Court of Appeal decision**
  - **Claims against charities will likely increase**
  - **Special purpose trust endowments will be at risk to creditors of the charity**
  - **The ability of donors to create enforceable restricted gifts will be weakened**
  - **Donors will be reluctant to give large gifts directly to an operating charity**

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– **Developing a strategy in response**
  - **Utilize an arms length parallel foundation**
  - **Utilize a community foundation or trust company**
  - **Structure gift as a determinative gift with a gift over to another charity**
  - **For more information see www.charitylaw.ca article on "*Donor Restricted Charitable Gifts Revisited: A Practical Overview*"**

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Avoiding Liability in Gift and Fundraising Programs

- **Gifts of Shares**
  – **Gift of shares or interests in a business will be subjected to the *Charitable Gifts Act* (Ontario)**
    - **Charities cannot own more than a 10% interest in a business for longer than 7 years**
    - **If a charity owns more than a 50% interest in a business then reporting requirements to P.G.T. apply**

  – **Potential liability in relation to improper valuing and receipting of shares of publicly traded companies**

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- **Need to review CRA position on determining fair market value**
- **Need to review factors outlined by CRA in valuing shares as set out in Charity Newsletter No. 12**

- **Gifts of real estate**
  – **Three year restrictions on property investments under the *Charities Accounting Act* (Ontario)**
  – **Liability for toxic property and need for environmental assessment**
  – **Need for due diligence searches**
  – **Inability of charity to manage real property**

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- **Receiving used "gifts in kind"**
  - **Need for appraised fair market value**
  - **Potential liability to third parties from using recycled property**
- **Self insured gift annuities**
  - **The difference between self insured and reinsured gift annuities**
    - **Self insured gift annuity**
    - **Reinsured gift annuity**
  - **Legal risks associated with self insured annuities**
    - **Lack of corporate authority**

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    - **Violation of the *Insurance Act* (Ontario)**
    - **Operational financial risks**
    - **Restrictions on foundations issuing annuities**
- **Debt instruments forgivable on death**
  - **Need testamentary instrument to forgive debt**
  - **If not properly forgiven, will become an asset owing to the estate**
- **Transferring capital funds between charities**
  - **Ensure that there are charitable objects to permit the transfer of funds**
  - **Identify donor restricted charitable gifts**

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  - **Identify impossible or impractical donor restrictions**
  - **Change of trustees by deed of trust**
  - **Unrestricted funds to be applied for original charitable purpose**
- **Investment issues in fundraising**
  - **Determine what investment power applies**
  - **Review prudent investment standard**
  - **New delegation of investment decision making under *Trustee Act* (Ontario)**
  - **See www.charitylaw.ca, Charity Law Bulletin #8 for more details**

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- **Managed or pooled investment of charitable funds**
  - **Does the recipient charity have the corporate power to operate a pooled fund?**
  - **Does the investment power of each participating charity permit it to invest charitable monies by pooling monies with a third party?**
  - **Does the *Loan and Trust Corporations Act* (Ontario) have application?**
  - **Does the *Bank Act* (Canada) have application?**
  - **Does the *Securities Act* (Ontario) have application?**
  - **Is court authorization required to pool investment funds of various charities?**

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- **The impact of regulations under the *Charities Accounting Act* (Ontario) for commingling**
  - **No relief to the common law rule prohibiting directors from receiving remuneration**
  - **Indemnification of directors and officers and liability insurance is now permitted**
  - **Charities may commingle restricted and special purpose funds provided that detailed accounting records are maintained**
  - **However, commingling of restricted funds and general funds are not permitted**

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- **Utilizing ten year gifts in charitable fund raising**
  - **Need to document ten year gifts**
  - **Expenditure of income by foundations and the 4.5% disbursement quota**
  - **Consequences of expending capital prior to expiry of ten years**
  - **Expenditure of ten year gifts after expiry of ten years**
  - **Managing ten year gifts**
    - **Keep the ten year gifts in a separate account**

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- **This would help to accomplish the following**
  - **Keep track of original capital and capital gain**
  - **Less chance that capital would be expended**
  - **Different investment powers could apply if necessary**
- **Problems in transfer of ten year gift to foundations**
- **Problems in transfer of ten year and other long term gifts from private foundations to public foundations**

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- **Conditional gifts**
  - **What is the nature of a conditional gift?**
    - **A conditional gift involves the charity becoming the beneficial owner of the gift subject to being defeated by a condition**
    - **With a special purpose charitable trust, the charity never becomes the beneficial owner of the gift but instead holds it in trust**
  - **Receipting conditional gifts**
    - **Condition precedent gifts cannot be receipted**
    - **Condition subsequent gifts may be receiptable:**

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  - **Reversion to donor precludes receipting**
  - **Reversion to another charity will likely be receiptable**
- **When will excessive donor control defeat a gift**
  - **Donor advised fund where the donor is allowed to direct control**
  - **Donor retaining the right to direct investments**
  - **Donor requiring that the gift must be invested in only one type of investment**
  - **Donor approving the recipient of a scholarship**
  - **Donor appointing the nominee to the board of directors**
  - **Donor approving the appointing of the CEO**

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- **Bill C-45 Amendments to the Criminal Code (Westray Mines)**
  - **In effect criminalizes situations which previously were only matters of negligence**
  - **Charities, directors and officers may be exposed to personal liability**
  - **insurance may not be available for defence costs**
  - **See Charity Law Bulletin #35 for more details**

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- **Protecting against liability from anti-terrorism legislation**
  - **Legislation is complicated, see www.antiterrorismlaw.ca for article *"Charities and Compliance with Anti-terrorism Legislation: The Shadow of the Law"***
  - **Charity and its directors need to have a working knowledge of the anti-terrorism legislation in making a gift to charity**

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- **Even gifts that unintentionally end up in the wrong hands through agents of the charity can violate anti-terrorism legislation and create exposure to liability for the charity and its board**
- **A charity could lose its charitable status**
- **Directors, donors and fundraisers could be found personally liable**
- **Need to develop a due diligence checklist to avoid unintentional violations of the legislation**
- **However, anti-terrorism legislation generally involves strict liability legislation so due diligence is not necessarily a defence**

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Business Activities of Hospitals and Foundations

Adam M. Parachin
February 10, 2004

Can Hospitals / Foundations engage in business activities?

- Yes - BUT there are restrictions

What are the sources of the restrictions on business activities?

- 3 general sources:
  1. Common Law Definition of Charity
  2. *Income Tax Act* (Canada)
  3. Provincial Charities Statutes

Common Law Definition of Charity

- How does the common law definition of charity impact scope of permissible business activities?
  - Common law requires *exclusively* charitable objects
  - Business activities permissible BUT "profit" must not be an unstated collateral purpose
  - Business activities must therefore not be carried on to so great an extent that the charity may be considered to have a business purpose

Does common law allow charities to charge fees for goods/services?

- Charging fees ≠ business purpose ≠ profit motive
- Quantum of Fees: Cost Recovery Fees vs. Market Level Fees
- BOTH Cost Recovery and Market Level Fees are permissible
- BUT Market level fees can raise concern re profit motive

Does common law allow charities to charge fees for goods/services?

- Steps to avoid appearance of profit motive:
  1. Fee schedule must not limit good/service exclusively to the wealthy
  2. Profit portion of fee used to underwrite lower fees for persons of little means
  3. Fees supplement donations as a source of revenue

Income Tax Act (Canada)

- How does the *Income Tax Act* restrict permissible business activities?
  - Rules vary with "type" of charity (S. 149.1)
  - "Private Foundation" may NOT "carry on" any "business"
  - "Charitable Organization" + "Public Foundation" may "carry on" only a "Related Business"
  - Expenditures on related business do NOT count towards disbursement quota obligations

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Four Questions

1. What is a "business"?
2. What does it mean to "carry on" a "business"?
3. When will a "business" constitute a "related business"?
4. What are consequences of impermissible business activity?

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What is a Business?

- No statutory definition
- Question of fact whether activity is a "business"
- 4 general criteria:
  1. Intention to make profit?
  2. Potential to make profit?
  3. Existence of profits?
  4. Person undertaking the activity?
- Fundraising events can constitute a "business"

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Business Activities vs. Investments

- *Income Tax Act* generally does not restrict investments of charities
- No "bright line" test to distinguish "business" from "investment"
- General rule is that investment is PASSIVE whereas business is ACTIVE
- Investments in Limited Partnerships problematic

What Does It Mean to “Carry On” a “Business”?

- "Carrying on" entails CONTINUOUS / REGULAR operation
- Infrequent business activity with discrete "start" and "end” ≠ "carrying on"
- CCRA will view each discrete "business" activity separately to determine frequency of activity

When Will a Business Constitute a “Related Business”?

- Two types of "related business"
- Business where "substantially all" employed are volunteers
  - i.e., 90% are volunteers
- Business linked & subordinate to charity's purpose

When will a business be "linked" & "subordinate" to a charity's purpose?

- *Alberta Institute on Mental Retardation v. Canada* [1987] 3 F.C. 286
  - "Destination Test"
- *Earth Fund v. Canada* [2002] F.C.A. 498
  - "Destination Test" is insufficient
  - *Alberta Institute* restricted to its unique facts

CCRA Policy Statement - CPS 019 (March 31, 2003)

- Provides criteria for when business is "linked" / "subordinate" to charity's purpose

Linked:

1. Supplements charitable programs
   - i.e., hospital parking lot / gift shop
2. Off-shoot of charitable program
   - i.e., church sells CDs of choir
3. Use of Excess Capacity
   - i.e., church rents out parking lot during week
4. Sales promoting the Charity
   - i.e., goods with charity's logo, etc

CCRA Policy Statement - CPS 019 (March 31, 2003)

Subordinate:

1. Small proportion of charity's attention / resources
   - i.e., human resources, buildings, board meetings
2. Business integrated to charitable operations
   - i.e., advertising makes reference to the charity; goods and services bear relationship to the charity
3. Charitable purpose dominates decision making
   - i.e., are charitable assets being exposed to risky business?
4. No private benefits
   - i.e., business should not confer benefit on members / non-arm's length persons

What are Consequences of Impermissible Business Activity?

- Charitable registration will be denied / revoked
- CCRA will generally allow charity to take remedial steps before revocation occurs

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Provincial Charities Statutes

- What provincial charities statutes limit permissible business activities?
  - *Charities Accounting Act* ("C.A.A.")
  - *Charitable Gifts Act* ("C.G.A.")

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Re *Centenary Hospital Association and Public Trustee* [1989] O.J. No. 2951

- Holding of court suggestive that C.A.A. and C.G.A. NOT applicable to public hospitals
- Parallel hospital foundations are, however, subject to C.A.A. and C.G.A.

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How does C.A.A. and C.G.A. impact permissible scope of business activities?

- C.A.A. and C.G.A. do not explicitly restrict business activities BUT both statutes contain provisions relevant to business activities

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C.G.A.

- S. 3 provides that where an interest in a business is "given to" or "vested in" in a charity, the portion of the interest in excess of 10% must be disposed of within 7 years
- C.G.A. not generally understood to preclude charity from directly conducting a business activity
- 10% restriction limits the ability of charities to invest / carry on a business through another legal entity, i.e., another corporation
- P.G.T. interprets C.G.A. to preclude use of holding corporations

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C.A.A.

- S. 8 requires land held by charity to be used for its charitable purposes
- 3 year grace period
- Limits prospects for land leasing business and acquiring land for exclusively purpose of conducting business thereon

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