

ENTREPRENEURSHIP CENTRE

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Incorporation: Charitable Status vs Non-profit Status

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OVERVIEW OF TOPICS

- Considering Incorporation
- The Nuts and Bolts of Incorporation
- Bringing your Corporation to Life
- Effectively Using your Corporation
- Charitable Status vs. Non-profit Status

A. CONSIDERING INCORPORATION

1. Characteristics of an unincorporated association
 - A group of individuals who associate on a voluntary basis for a common purpose reflected in its constitution or memorandum of association
 - The association has no legal existence apart from the members themselves
 - The members of the association may be liable for debts and civil liabilities of the association
 - Unable to sue or be sued, contract or hold property in own name

2. Advantages of incorporation

- Limited liability protection of members
- Perpetual existence as separate legal entity from its members, directors and officers
- More effective organizational control
- Indemnification of directors and officers
- Can maintain and defend legal actions
- Can own assets in name of corporation; no need to use individual trustees

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3. Disadvantages of incorporation

- Costs
 - Completing corporate filings
 - Maintaining corporate records
 - Drafting corporate by-laws
- 4. When is incorporation appropriate?**
- Anytime, but particularly when:
 - Contemplating expansion or incurring debt
 - Operations involving liability exposure

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5. Nature of a non-share corporation

- A share capital corporation is owned by its shareholders and the purpose of the corporation is to generate profit
- A corporation without share capital is not owned by anyone but is governed by its members, officers and directors for non-profit purposes

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B. NUTS AND BOLTS OF INCORPORATION

1. Preparation

- Designate an individual or small committee to co-ordinate incorporation
- If applicable, obtain unincorporated association's approval to proceed with incorporation

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2. Choice of jurisdiction

- Federal or provincial?
- Both jurisdictions in process of enacting new legislation
- Discuss choice of jurisdiction with legal counsel
- This presentation will generally use current *Canada Corporations Act* for illustrative purposes

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3. Governing documents

- Letters Patent (Articles of Incorporation)
 - Establishes the corporate purposes and restrictions
 - If corporation intends to apply for charitable status important that objects be exclusively charitable
 - Location of head office
 - Dissolution clause – assets to an organization with similar objects

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- **General operating by-law**
 - Sets out governance structure and key internal operational procedures
 - Key provisions under the current federal act: number and qualifications of directors; election of directors; classes and qualifications of members; procedures for admission of members; notice and quorum requirements for meetings of directors and members; appointment of officers; committees; fiscal year end; signing authority;

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3. Approval of unincorporated association

- Obtain formal approval of members of unincorporated association of application for incorporation and draft general operating by-law
- Confirm availability of corporate name
- Submit documents to federal government

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C. BRINGING YOUR CORPORATION TO LIFE

- After issuance of letters patent, necessary to confirm the structure of the corporation through adoption of initial organizing resolutions which will confirm the first directors and members, adopt by-laws, approve the banking resolution etc.
- Corporate filings; business names registration
- Transfer assets from unincorporated association to corporation

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D. CHARITABLE STATUS VS NON-PROFIT STATUS

1. Generally

While both types of entities operate on a not-for-profit basis, they are defined differently under the *Income Tax Act*

2. The fundamentals of a charity

- At common law includes:
 - Relief of poverty
 - Advancement of education

- Advancement of religion
- Other purposes beneficial to the community as recognized by the courts

3. What are the tax advantages of being a charity?

- A charity does not pay tax on income or capital gains
- A charity can issue charitable receipts to donors as tax credits for income tax purposes

4. Application for charitable status

- Completed application signed by two directors or officers
- Application requires financial information and detailed statement of activities to be carried out in furtherance of objects

5. Requirements of charitable status

- Devote its resources to charitable purposes and activities carried on by itself
- Must not pay any of its income to its members, other than salaries or reimbursement for expenses

- **Keep proper books and records**
- **File registered charity information return within six months of the year end**
- **Restrictions on business and political activities**

6. The fundamentals of a non-profit organization

- **Club, society or association**
- **Must not be a registered charity or a charity at common law**

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- **Organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or any other purpose except profit**
- **No part of the income can be payable or available to any proprietor, member or shareholder (other than salaries, expenses)**
- **CRA has indicated that, “profit should generally be unanticipated and incidental to the purpose or purposes of the organization”**

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- **CRA has cautioned that retaining excess funds beyond immediate operating costs may be evidence that an organization is operating with a profit purpose, but, “this will not in and of itself result in the organization failing to qualify as a 149(1)(l) entity”**
- **Therefore non-profits must justify any excess surplus**

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7. What are the tax advantages of being a non-profit organization?

- A non-profit organization does not pay tax on income or capital gains, except income from property of an organization whose main purpose is to provide dining, recreation or sporting facilities
- A non-profit organization cannot issue charitable receipts for income tax purposes

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- It is up to CRA to determine whether or not a non-share capital corporation or an unincorporated association qualifies as a nonprofit organization under subsection 149(1)(l) of the ITA
- Examples would include
 - Recreational clubs
 - Service clubs
 - Trade associations
 - Professional associations

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8. What are other advantages of being a non-profit organization?

- No CRA application or approval process
- No T3010 annual return
- No fundraising guidance requirements
- No restrictions on political activities
- Not as many restrictions on how to spend resources

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9. What are the filing requirements for a NPO?

- If incorporated must file a tax return even if exempt from tax (short form)
- May have to file an NPO Information Return if total amount received or receivable in fiscal year for dividends, interest, rentals, or royalties is more than \$10,000; or
- The assets in the fiscal year exceed \$200,000

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CONCLUSION

- Important to know what you wish to accomplish
- No one size fits all
- Be aware of the regulatory requirements
- Start off in way you would like to continue

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