
**CHRISTIAN LEGAL SOCIETY
50TH ANNIVERSARY CONFERENCE**

Chicago – October 21, 2011

**Legal Considerations in Establishing
a Charity in Canada**

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2

1. INTRODUCTION

- Some U.S. tax exempt organizations may want to develop a base of support in Canada and/or launch a charitable program in Canada
- In order to accomplish either of these goals, it normally would be necessary to be able to issue tax receipts for donations in Canada
- While U.S. tax exempt organizations can generally operate in Canada on a tax-exempt basis, they cannot issue charitable receipts for donations from Canadian residents
- To do so, a U.S. tax exempt organization would need to establish a “registered charity” in Canada

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3

- This presentation will address the steps that are required to establish a “registered charity” in Canada, as well as review some of the alternative ways of issuing tax receipts for Canadian donors
- Resources that are available for more information on this topic include:
 - “How to Structure and Begin Charitable Operations in Canada”(Part I) and “Choosing a Form of Organization for Operations in Canada” (Part II) published in the *Journal of Taxation of Exempt Organizations*, available online at <http://www.charitylaw.ca>
 - Charity Law Bulletin No.96, “Applying for Federal Incorporation and Charitable Status”, available online at <http://www.charitylaw.ca>

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4

- Topics covered in this seminar include:
 - Alternatives to Establishing a Registered Charity
 - Advantages of Establishing a Registered Charity
 - Basic Requirements of Registered Charities
 - What is “Charitable” at Law in Canada?
 - Available Legal Forms
 - Process of Becoming a Registered Charity
 - Acceptable Cross-Border Payments
 - Anti-Terrorism Compliance Considerations
 - Options for Establishing an International Structure
 - Franchise Arrangement for Canadian Operations

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5

2. WHAT ARE THE ALTERNATIVES TO ESTABLISHING A REGISTERED CHARITY IN CANADA?

- a) Donations to U.S. *Internal Revenue Code* (“IRC”) ss.501(c)(3) Tax Exempt Organizations by Canadian Donors with Regards to U.S. Source Income
- Article XXI(7) of the *U.S.-Canada Income Tax Convention* (“Treaty”) provides that a gift by a Canadian resident to a 501(c)(3) tax exempt organization will be treated as a gift to a “registered charity” – i.e. the Canadian donor may claim a charitable tax credit (individual) or deduction (corporation) for the donation against U.S. source income

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6

- The U.S. charity:
 - 1) Must be a U.S. resident that is generally tax exempt; and
 - 2) Could qualify in Canada as a “registered charity” if it were a resident of Canada and created or established in Canada
- This benefit is limited – tax relief is only available up to 75% of the donor’s U.S. source net income
- Exception: The benefit is not restricted to the Canadian donor’s U.S. source income if the recipient of a gift is a college or university at which the Canadian resident or a member of his or her family is or was enrolled

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7

b) Canadian Donors Who Are Commuters

- ss.118.1(9) of the *Income Tax Act* ("ITA") permits gifts to U.S. charities by Canadian donors who are commuters
- Donations are not limited to U.S. source income
- Requirements:
 - 1) Donor must reside in Canada near the border
 - 2) Donor must commute to his or her principal place of employment or business in the U.S.
 - 3) Donor's chief source of income for the year is from the said employment or business in the U.S.
 - 4) The donation is made to a U.S. religious, charitable, scientific, literary or educational charity created or organized under the laws of the U.S. that would be allowed a deduction under the IRC

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c) Donations to Prescribed Universities

- Canadian donors are permitted to make charitable donations to prescribed foreign universities if their student body ordinarily includes students from Canada
- These universities must apply and are named in Schedule VIII of the *Income Tax Regulations*
- The qualifying entities must be universities themselves
- An entity (e.g., a centre or a foundation) whose activities and funds are dedicated to achieving the goals of a particular university do not qualify
- The receipt can be used as a tax credit for individuals or a deduction for corporations

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9

d) Donations to United Nations and Its Agencies

- Canadian donors are permitted to make charitable donations to the United Nations and its agencies
- It is not clear what entities are in fact agencies of the United Nations for the purpose of the definition of "qualified donees"
- Therefore, need to check with the Canada Revenue Agency ("CRA") to obtain written confirmation
- The receipt can be used as a tax credit for individuals or a deduction for corporations

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10

- e) Donations to Donees of the Government of Canada
 - Canadian donors can make donations to charitable organizations outside of Canada to which Her Majesty in right of Canada has made a gift
 - 1) During a calendar year or in the 12 months immediately preceding that calendar year for individual donors, or
 - 2) During the fiscal period or in the 12 months immediately preceding that fiscal period for corporate donors

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11

- The list is kept by CRA – last revised on September 1, 2011 (e.g. Aga Khan Foundation, William J. Clinton Foundation)
- CRA is responsible for determining whether the entity receiving a gift from Her Majesty in right of Canada is a “charitable organization” according to Canadian law, and whether the payment to the foreign entity is a “gift” at law
- The receipt can be used as a tax credit for individuals or a deduction for corporations

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12

- f) Receipt of Income by Certain U.S. Charities
 - Article XXI(1) of the Treaty permits certain U.S. religious, scientific, literary, educational or charitable organizations relief from Canadian income tax on certain Canada source income
 - The organization must be resident in the U.S.
 - Income derived in Canada must not be derived from the carrying on of a trade or a business or from a related person that is not an entity in Articles XXI(1) or XXI(2)
 - Eligible organizations may derive income from various activities in Canada (e.g. membership fees, rental income, royalty fees, license fees, interests etc.)
 - Applies to income that is exempt from tax in the U.S.

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16

- If it is a "charitable organization", then it must devote all of its resources to its charitable activities
- If it is a "public foundation" or "private foundation", then it must be constituted and operated exclusively for charitable purposes
- The charity must ensure that no part of its income is payable to, or is otherwise available for the personal benefit of any proprietor, member, shareholder, trustee, or settlor
- The charity must meet a public benefit test:
 - 1) Its activities and purposes provide a tangible benefit to the public;
 - 2) The people eligible for benefits are either the public as a whole or a significant section of it; and

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17

- 3) The charity's activities must be legal and must not be contrary to public policy
- The charity must meet its disbursement quota each year
 - The disbursement quota is a prescribed amount that registered charities must disburse each year in order to maintain charitable registration
 - The 80% disbursement quota was eliminated in 2010
 - A registered charity, though, must spend each year 3.5% of all assets not currently used in charitable activities or administration ("investment assets")

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18

- The 3.5% disbursement quota applies if investment assets exceed a threshold of \$100,000 for charitable organizations, and \$25,000 for public and private foundations
- Sufficient books and records must be maintained in Canada in French or English so that CRA can check:
 - Whether funds are being spent on a charity's own activities or on gifts to qualified donees
 - Whether the charity is directing and controlling the use of its resources
 - Whether there are grounds to revoke the charity's status
- Failure to do so could be used by CRA as a basis to revoke a charity's charitable status on an audit

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- b) Charitable Trust
 - A written trust agreement signed by settlor(s) that designates trustee(s) of certain charitable property, pursuant to a statement of charitable purposes
 - Easy to form and avoids formalities of incorporation
 - However, requires appointment of successive trustees
 - Potential for personal liability for trustees
- c) Charitable NFP Corporation
 - Corporation has perpetual existence
 - Provides limited liability protection for members
 - Provides stability in structure

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23

7. WHAT IS THE PROCESS OF BECOMING A REGISTERED CHARITY IN CANADA?

- May incorporate federally or provincially
 - May be desirable to federally incorporate, as it ensures a national presence and that the charity may use its name across Canada
 - e.g. May register extra-provincially without having to obtain approval of the corporate name of the charity on a province by province basis
 - *Canada Not-for-profit Corporations Act* came into force October 17, 2011, and Ontario *Not-for-Profit Corporations Act* is anticipated to be proclaimed in late 2012
- Conduct a name search of the proposed corporate name
- Apply for charitable status to CRA using form T2050

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24

- Processing time for charitable status application – approximately 8 -10 months
- Administrative fairness letter – CRA does not contact the applicant directly but sets out in a letter any outstanding issues that require rectification
 - Time limit for replying to letter is usually 30 – 60 days
- If charitable status is granted, the effective date of charitable status is normally the later of the date of incorporation and January 1st of that year
 - A registered charity will be able to issue charitable receipts for property donations received as of or after the effective date and for donations of cash gifts as of January 1st of that year

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- After registration, if the charity operating in Ontario, must notify the Public Guardian and Trustee
- In the process of granting charitable status, CRA will designate the applicant as a "charitable organization", a "public foundation", or a "private foundation", depending on the designation requested in form T2050 and its opinion of whether the applicant meets the statutory definition of the requested designation
- While CRA is reviewing the application for charitable status, the lawyer should arrange to have the initial organizing resolutions for the corporation prepared and a report sent to its board of directors explaining the board's responsibilities, duties, and liabilities
- An information return (T3010-1) must be filed no later than six months after the end of a charity's fiscal period

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26

8. WHAT CONSTITUTES ACCEPTABLE PAYMENTS BY A CANADIAN REGISTERED CHARITY TO A U.S. COUNTERPART?

- CRA Guidance on Canadian Registered Charities Carrying out Activities Outside of Canada, CG-002 ("Guidance") is available at <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>
- A registered charity may only use its resources in two ways:
 - 1) In making gifts to qualified donees
 - A registered charity can make gifts to other organizations that are on the list of qualified donees
 - Includes: other registered charities, prescribed universities outside Canada, the United Nations, etc.

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27

- 2) Carrying on its own activities
 - Those activities which are directly under the charity's control and supervision and for which it can account for any funds expended
 - The charity is actively involved in programs that are intended to achieve its charitable purposes (e.g. directly funding its own employees and/or volunteers in carrying out its programs)
 - Charities cannot carry out its charitable purposes by simply giving monies or other resources to an other organization that is not a qualified donee
- CRA permits charities to make payment outside of Canada to and work with U.S. counterparts (i.e. an "intermediary" – a person or non-qualified donee that is separate from the charity and who the charity works with to carry out its activities)

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31

- Insurance concerns:
 - Some insurers may be concerned about vicarious liability risks associated with agency relationships
 - Unless these risks are disclosed to the insurer, they may not be covered by insurance policies
 - A charity should advise its insurer in writing of the nature and extent of its agency relationships
- Disbursement quota concerns:
 - Until the agent spends funds from the charity, there is no charitable expenditure that can be counted toward the charity's disbursement quota
 - The charity would have to monitor the timing of when the agent expended funds on behalf of the charity in relation to calculating its 3.5% disbursement quota, if applicable

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32

2) Joint venture participant

- A charity can also carry on its activities jointly with other organizations or individuals through a joint venture relationship where the participants pool their resources in order to accomplish their goal in accordance with the terms of a joint venture agreement
- The charity is not relying entirely on the joint venture participant to carry out activities for the charity
- A charity can work with non-qualified donees as long as the charity is exercising control over the activities proportionate to the resources it is providing and it can demonstrate this fact

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- Generally, a joint venture governing body is required to establish, conduct and oversee the joint venture
- A charity must be able to show that its share of authority and responsibility over a venture allows it to dictate, and account for, how its resources are used
- e.g. Where the registered charity contributes 40% of the fundraising for the project, then the charity should have 40% of the voting rights on the governing board
 - However, the charity may be outvoted by the other joint venture participants and its resources used for purposes outside the agreement

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34

- The agreement between the parties should include a provision that allows the charity to discontinue devoting its resources to the venture if its resources are to be used for purposes other than those that have been previously agreed upon
- Before entering into a joint venture agreement, a registered charity should ensure that it can carry out and comply with the terms of the agreement and actually do so in order to avoid the arrangement being viewed as a paper arrangement only

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35

3) Co-operative participants

- A "co-operative participant" is an organization that works side-by-side with a "registered charity" to complete a charitable activity
- The charity and the other organization(s) do not pool their resources and share responsibility for the project as a whole – participants are responsible for only parts of the project
- e.g. a charity that provides care for the sick joins with a foreign organization that is not a qualified donee to build and operate a medical clinic in an isolated area
 - The charity agrees to provide qualified nursing staff at the clinic, but will not participate in other parts of the project, such as the construction of the building, buying medicine, etc.

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36

4) Contractors

- A "contractor" is an organization or individual that a charity hires to provide goods and/or services
- Contractors can be organizations or individuals that do not need to be either qualified donees under the ITA or recognized charities in their own countries
- e.g. a Canadian registered charity with charitable purposes may contract with organizations in different countries to conduct charitable activities there
- The registered charity must give specific instructions to its contractors
- The charity must exercise direction and control over the contractor and monitor the use of its resources

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37

- There are several advantages in using a contractor
- Limitations in Liability:
 - The automatic vicarious liability that exists between a registered charity and its agent in an agency relationship does not generally exist with a contract for services
 - Any liability associated with the work being carried out by the third party contractor under the contract for service is limited to the said contractor and does not extend to the charity
 - However, a plaintiff may argue that the charity exercised too much day-to-day control over the contractor's activities and therefore is vicariously liable for the contractor's actions

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38

- Financial Statements
 - In a contract for service, the assets that are transferred to the third party organization in exchange for services are no longer the assets of the registered charity and therefore do not need to be reflected in its financial statements
- Segregation of Funds
 - Unlike an agency relationship, there is no need to segregate funds

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39

- Disbursement Quota
 - Once assets have been transferred to a third party contractor under a contract for service for goods or services that are an integral part of the registered charity's work, they are considered to have been expended for the purposes of the registered charity's 3.5% disbursement quota
 - For disbursement quota purposes, the time of payment of monies by a charity to the contractor under a contract for services would be the time of the expenditure and not when the contractor fulfills the terms of the contract
- Insurance
 - The absence of vicarious liability may make a contract of service attractive to an insurer

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- Control and Direction of Resources
 - CRA requires registered charities to take all necessary measures to direct and control the use of its resources through an intermediary
 - Although not formally required under the Guidance, CRA recommends that charities should have a written agreement in place with any intermediaries that they work with
 - Exception: If the money spent on a one-time activity is \$1,000 or less
 - Other forms of communication may be used to show direction and control, but a written agreement provides the best evidence

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41

- CRA recommends that the following measures to be adopted to direct and control use of a charity's resources
 - Create a written agreement and implement its terms
 - A clear, complete, and detailed description of activities is communicated to the intermediary
 - Monitor and supervise the activity
 - Provide clear, complete, and detailed instructions to the intermediary on an ongoing basis
 - If an agency relationship exists, segregate funds and maintain separate books and records
 - Periodic transfer of resources based on performance
- Charities must maintain a record of steps taken to direct and control the use of its resources

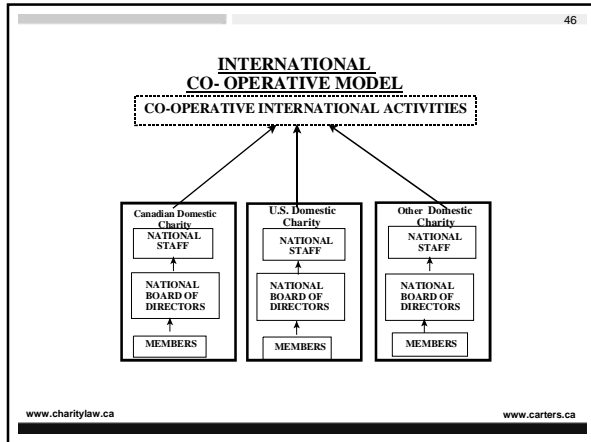
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42

9. ANTI-TERRORISM COMPLIANCE CONSIDERATIONS

- Canada has extensive anti-terrorism legislation that is similar to the U.S. *Patriot Act*
- CRA's Checklist for Charities On Avoiding Terrorist Abuse is specifically referenced in the Guidance, available online at <http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/vtb-eng.html>
 - e.g. Does the charity know about the individuals and entities associated with terrorism, which are listed under the *United Nations Act* and the *Criminal Code*?
 - e.g. Has the charity read CRA Guidance on keeping adequate books and records, activities, engaging in allowable activities, operating outside Canada, and charities in the international context? Is the charity following this guidance?

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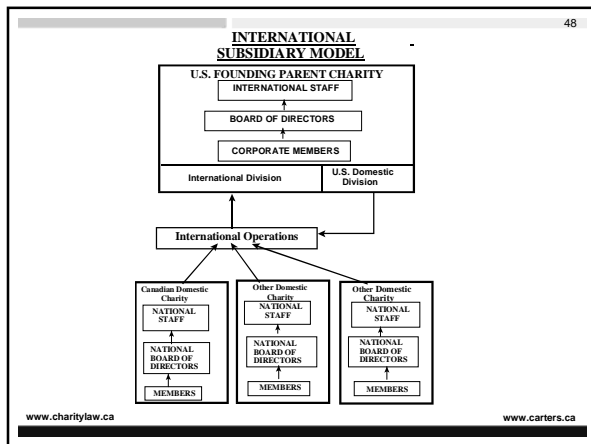


47

b) International Subsidiary Model

- The U.S. charity (which is the founding charity) functions as a domestic organization in the U.S. and as the international parent organization that coordinates charitable activities of member domestic charities (in other countries)
- U.S. organization tends to dominate the international operations and to a certain extent the internal operations of each domestic charity
 - e.g. the board of Canadian charity is dominated with either U.S. board members or nominees of the U.S. organization
 - There may be nominal or token participation by the Canadian board members on the board of the U.S. organization

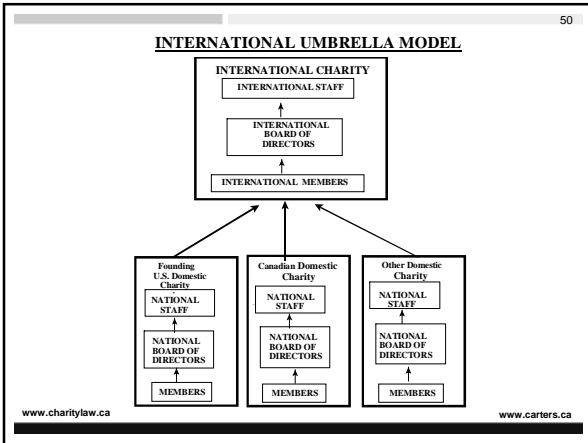
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49

- c) International Umbrella Organization
 - Each country has its own domestic charity, including the U.S. (despite the U.S. organization being the founding charity)
 - A separate charitable corporation is incorporated in the U.S. to act as the international umbrella organization
 - Establishes, co-ordinates and enforces international standards for charitable operations for all domestic charities (including the U.S. domestic charity)
 - Normally owns all the applicable trade-marks in each country and licenses them to each domestic charity
 - The board of international charity consists of directors elected on a proportionate basis by all domestic charities
 - International charitable corporation does not control the activities of domestic charities in their own country

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51

11. ESTABLISHING A FRANCHISE ARRANGEMENT FOR CANADIAN OPERATIONS

- With the last two international structures described above, the most effective means of documenting the relationship is through a franchise arrangement
- Otherwise, in the event of a disagreement with the U.S. organization, the Canadian charity could assert that it owns its name, trade-marks and associated goodwill in Canada
- As separate and autonomous legal entities, the governing U.S. organization and Canadian charity have to carefully structure their relationship to ensure that the two organizations work cooperatively under the oversight, but not under the control of, the governing U.S. organization in order to avoid cross-over liability

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- A franchise arrangement will generally include the following factors:
 - An association agreement that will address:
 - Basic expectations of the U.S. organization;
 - The need for similar charitable purposes;
 - Corporate governance provisions;
 - License of intellectual property to Canadian charity;
 - Terms related to the carrying out of operations; a dispute resolution mechanism;
 - Indemnification;
 - Insurance requirements, etc.

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- The association agreement would include a description of the basic terms required for the incorporating documents of the Canadian charity
 - The charity would agree that its incorporating documents would need to reflect certain basic requirements (that are consistent with Canadian law and do not diminish its autonomy)
 - U.S. organization could have veto over some fundamental changes in Canadian charity's corporate documents, plus the right to nominate a certain number of board positions (up to 49% of the board membership)

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- Intellectual property considerations:
 - Does the names and trade-marks of the U.S. organization require protection in Canada?
 - If so, then trade-mark registration should be applied for in Canada and every country it operates in presently and/or intends to operate in
 - The trade-mark application and registration should be in the name of the U.S. organization where possible
 - The U.S. organization needs to enter into a trade-mark license agreement with the Canadian charity to identify ownership of trade-marks and delineate terms of use of trade-marks

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55


- Need to also register Internet domain names that include the name and/or trade-marks involving .ca and other suffixes
- If the member Canadian charity is already operating in Canada without a license agreement, an agreement acknowledging that it is and has been a licensee of the trade-marks owned by the U.S. organization should be entered into
- File "proposed use" trade-mark applications in Canada prior to commencing operations

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56

- Need to also license applicable copyrights
 - Are any of the U.S. organization's works subject to copyright protection, and if so, is copyright registration necessary?
 - Has the U.S. organization licensed copyrights to the Canadian charity, either as part of an international association agreement or a separate copyright license agreement?
- Need to enforce licensing provisions for intellectual property that are set out in the association agreement as well as trade-mark or copyright license agreement to avoid assertion of "estoppel" by Canadian charity

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