
THE OTTAWA REGION
Charity & Not-for-Profit Law Seminar

Ottawa – February 2, 2012

**Foreign Activities:
How to Avoid Problems**

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 BARRISTERS SOLICITORS TRADEMARK AGENTS	THE OTTAWA REGION Charity & Not-for-Profit Law Seminar Ottawa – February 2, 2012
Foreign Activities: How to Avoid Problems	
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A. OVERVIEW	
<ul style="list-style-type: none">• Review of basic CRA requirements for charities engaged in foreign activities• How to carry out a “pre-audit” compliance review if your charity is engaged in foreign activities	
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B. CRA REQUIREMENTS IN CARRYING OUT FOREIGN ACTIVITIES	
<ul style="list-style-type: none">• CRA Guidance on Canadian Registered Charities Carrying out Activities Outside of Canada, CG-002 is available at http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html• Although it will not be discussed today, charities also need to be aware of a related CRA Guidance, using an Intermediary to Carry Out a Charity’s Activities Within Canada CG-004 http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/ntrmdry-eng.html?rss	
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- 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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- 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

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- CRA permits charities to make payments outside of Canada to and work with foreign 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)
- The Guidance states:

"When working through an intermediary, a charity must direct and control the use of its resources...A charity that does not **direct and control** its resources when working through an intermediary risks sanctions under the *Income Tax Act*, including the revocation of registered status." (Emphasis added)

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- There are four common types of intermediaries that can be used - CRA does not recommend using one type of intermediary over the other
 - 1) Agents
 - In an agency relationship, a registered charity can appoint an agent to act as its representative to carry out specific tasks on behalf of the charity
 - An agent is used when the charity cannot send its staff to a region to carry out an activity
 - The charity relies entirely on the agent to carry out its activities on its behalf

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- Agents can be organizations or individuals and do not need to be qualified donees under the ITA or registered charities in their own country
- The common law principle that the acts of the agent are those of the principal does not automatically meet the own activities test unless the charity is in fact directing what the agent does
- A charity may have one general agency agreement that covers most of the terms in a relationship with its intermediary as well as additional agreements that are specific for each particular activity

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- Liability concerns:
 - The actions of the agent are deemed to be the actions of the principal, and as a result, the principal is vicariously responsible for the actions of the agent
 - Vicarious liability can expose a registered charity to significant liability, both civil and criminal (e.g. anti-terrorism legislation)
 - CRA warns charities to consider how they structure agency arrangements because the existence of an agency relationship could expose them to significant liability for the acts of their agents

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- 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

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- 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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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 a joint venture agreement
- The charity is not relying entirely on the joint venture 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

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- However, the charity may be outvoted by the other joint venture participants and its resources used for purposes outside the agreement
- 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 non-agreed upon purposes
- Before entering into a joint venture agreement, a registered charity should ensure that it can and will carry out and comply with the terms of the agreement in order to avoid the arrangement being viewed as a paper arrangement only

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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 construction

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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 charity may contract with organizations in different countries to conduct charitable activities there in furtherance of the charity's own purposes
- 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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- 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

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- 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
- 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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- Disbursement Quota
 - Once assets have been transferred to a third party contractor under a contract for service 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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- CRA recommends the following measures 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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C. HOW TO CARRY OUT A COMPLIANCE REVIEW IF YOUR CHARITY IS CARRYING OUT FOREIGN ACTIVITIES

1. Preliminary Comments

- If your charity is engaged in activities outside of Canada using intermediaries, it will generally be more susceptible to an audit by CRA. The key question then becomes when will a CRA audit occur.
- For charities in this situation, it is recommended that they carry out their own "pre-audit" of such foreign activities to determine if there has been compliance with CRA requirements

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- Purpose of a pre-audit compliance review is to:
 - Identify all foreign activities/projects of the charity (past, present and future contemplated);
 - Review whether there has been compliance with CRA requirements for each activity/project;
 - Compile all key documents for each activity/project; and/or
 - Engage in remedial steps, as necessary

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- While CRA can audit any fiscal year of a charity, they generally will focus their audit some time within the last five (5) years of a charity's operations
- Therefore, these years should be the focus of a pre-audit, starting with the earliest financial year and working forward
- Such a pre-audit can be done by the charity itself, but involvement by its own legal counsel is highly recommended in order to establish solicitor-client privilege (including retaining an accountant)

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2. Identification of Foreign Activities/Projects Engaged in by the Charity

- Need to set out parameters of the review within the last five years
- Start the process by undertaking careful review of the charity's annual general ledger for years in question
- In reviewing the general ledger, need to identify each and every transaction which involved transfer of charitable property (cash or gifts in kind) to a non-qualified donee

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- These identified transactions should be copied and pasted into a separate excel spreadsheet (to be done by each financial year) for easier reference
- With each transaction found, then the charity needs to preliminarily identify the following:
 - Who the non-qualified donee recipient of the charity's property is;
 - Nature of the relationship with the non-qualified donee, e.g. agency, contract for services;

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- Whether the non-qualified donee recipient has utilized another organization to do the project in question, e.g. sub-agent or sub-contractor;
- Nature of activity/project for which charitable property was used;
- Whether this was a one-time transaction or one of many involving the non-qualified donee;

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- Nature of charitable property transferred; and
- What, if any, written documentation re the transfer is immediately accessible
- Need to prepare a summary memo identifying the transactions of potential concern, grouping them together as necessary and preliminarily identifying issues to be reviewed further with legal counsel (and the accountant)

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3. Determination if Charity's Foreign Activities Have Been in Compliance with CRA Requirements

- Once all transactions involving non-qualified donees have been identified, together with preliminary info regarding the transactions, then need to focus on gathering together all documentation showing "direction and control" by the charity over the project/activity in question
- Normally this involves the creation of project folders for each foreign activity/project undertaken by the charity

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- Once created and completed, each project folder can be numbered and then cross-referenced to the applicable transactions on the charity's general ledger
- This will facilitate easy access to the applicable project folder in the event questions arise about a particular project (or transactions on the general ledger) during a CRA audit
- In each project folder, a compliance checklist of all the steps/documentation required by CRA should be attached to the inside cover

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- Such a compliance checklist should include the following:
 - Date pre-audit completed for the project
 - Assigned project program number
 - Project type
 - Name of contractor
 - Name of sub-contractor, if applicable
 - Project name
 - Total funds transferred, together with interim fund transfers, if applicable, including amounts and dates

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- Required documents – indicate if required documents have been located, date completed and if any additional steps need to be taken
 - Original project proposal
 - Board approval of project (include copy of applicable board minutes)
 - Written agreement
 - Project designation(s) for contractor/agent (for initial and any interim fund transfers)
 - Wire transfer and letter
 - Any sub-agreement, if applicable

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- Sub-project designation(s) (for initial and any interim fund transfers)
- Interim project reports and, if applicable, sub-project reports
- Final project reports and, if applicable, sub-project reports
- Board acceptance of all project reports (include copy of board minutes)
- Photographs, brochures and other evidence that project took place

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- Any correspondence between the charity and contractor showing charity's supervision of and involvement in the project
- On-site visit reports by charity's directors, staff and/or volunteers
- Receipts/vouchers or audit letter in lieu of receipts/vouchers
- Additional notes, as required

- Need to complete the checklist for each project folder and, in so doing, identify which steps have (or have not) been taken by the charity and which documentation is (or is not) readily available

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- Need to prepare progress reports and pre-audit compliance reviews with the board of directors of the charity
 - Point out deficiencies
 - The board of directors need to feel a sense of ownership in the process
 - The board needs to oversee compliance process

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4. Compile All Key Documents for Each Activity/Project

- Once the charity has identified the documentation required to be in place for a project and stored in the applicable project folder, steps then need to be taken to locate and gather together the said documentation
- This will first involve a careful review of the charity's own records, e.g. minute books, past correspondence, e-mail searches, etc.
- Once all of the documentation in the charity's own records have been obtained, steps will need to be taken to locate all of the missing documentation

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- This is likely a good point to meet with legal counsel to review the current state of the project folders and the next steps to be taken by the charity
- The next key step will involve contacting the non-qualified donee agent or contractor to explain the documents the charity is looking to obtain and following up to make sure that they are provided for inclusion in the project folder
- This exercise will likely result in the charity discovering that certain required documentation was never prepared and may now need to be rectified

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5. Engage in Remedial Steps, as Necessary

- Whether remedial steps are necessary and, if so, which ones to take, will depend on the charity's particular circumstances
- This issue should be carefully reviewed with the charity's legal counsel before remedial documents are prepared
- Possible remedial steps could include the following:
 - Preparation of confirming written agreement and/or sub-agreements

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- Translation of reports, if not done to date, into English and/or French
- Obtaining of any supporting documents in relation to the project, e.g. photographs, news articles, on-site visit reports by charity representatives, project related correspondence to or from the charity, etc.
- Obtaining receipts/vouchers or an audit report in lieu thereof

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