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# THE 2006 ANNUAL CHURCH & CHARITY LAW™ SEMINAR

Toronto – November 8, 2006

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## The Ins and Outs of Transferring Charitable Funds Outside of Canada

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By Jacqueline M. Demczur, B.A., LL.B.

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**CARRYING OUT CHARITABLE PURPOSES**

**The *Income Tax Act* (“ITA”) permits a registered charity to carry out its charitable purposes, both inside and outside of Canada, in one of the following two ways:**

**a) Gifts to Qualified Donees**

- A registered charity can make gifts to other organizations that are on the list of qualified donees as set out in the ITA
- Qualified donees include, but are not limited to, other Canadian registered charities, certain universities outside Canada, the United Nations and its agencies, and a foreign charity that the Canadian Government has made a gift to in the preceding 12 months

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**b) Carrying on Its Own Charitable Activities**

- The carrying on of its own charitable activities requires a charity to be actively involved in programs and projects that are intended to achieve its charitable purposes
- This can be done by the charity directly funding its own employees and/or volunteers in carrying out its programs
- It is not permissible for a registered charity to carry out its charitable purposes by merely giving either monies or other resources to an organization that is not a qualified donee, regardless of whether the donee is inside or outside Canada

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- However, where a registered charity does not have its own employees or volunteers to carry out a project, it can work with other organizations regardless of whether that organization is a Canadian registered charity
- In order to comply with the ITA, the registered charity must use structured arrangements which allow it to retain direction and control over the program, as well as the resources that it contributes to the program

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**CARRYING ON CHARITABLE ACTIVITIES THROUGH INTERMEDIARIES AND WITH OTHERS**

**Overview of Options**

- There are two ways that a registered charity can work with other organizations to achieve its charitable purposes:
  - Working through intermediaries, such as an agent or a contractor
  - Working jointly with others
- These arrangements will require the registered charity and other organization to enter into a formal agreement

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- It is also important for the registered charity to ensure that it complies with the terms of the agreement. Failure to do so could potentially constitute grounds for charitable de-registration

**Co-operative Partnership**

a) Description

- Co-operative partnerships are used where a registered charity wishes to work alongside other organizations and with beneficiaries for the purpose of all of the parties carrying out a specific project

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- The partner organizations do not have to be qualified donees under the ITA
- Each organization would be a partner – equal or otherwise in the establishment, implementation and conducting of the project
- While the organizations in the co-operative partnership do not have to pool their resources in carrying out the project, each partner would be responsible for one or more elements of the project
- Providing that the registered charity is actively involved in one or more elements of the projects, (i.e. as opposed to merely contributing monies) it is considered to be carrying on its own charitable activities

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- b) Commentary
- There is joint and several liability for all partners involved in a co-operative partnership
  - There might be disbursement quota issues where the Canadian charity makes contributions to that portion of a project that is not directly charitable, such as providing administrative services only
- Joint Venture
- a) Description
- A registered charity and other organizations can pool together their resources to establish and operate a charitable program or project as a joint venture

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- The joint venture participant organizations do not have to be qualified donees under the ITA
- For example, the registered charity could contribute 20% of the funding to build an orphanage in a foreign country, together with the four other related charities located in different countries that each contribute an additional 20% to the joint venture
- The registered charity will be considered to be carrying on its own activities if:
  - It is an active participant exercising a proportionate degree of control in the joint venture program

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– It can evidence that its share of responsibility is proportionate to the level of financing that it contributes to the joint venture for long-term planning, day-to-day decision-making and financial commitments

- Generally, a joint venture management committee is required to establish, conduct and oversee the joint venture. Where the registered charity contributes 20% of the total monies and the committee is comprised of 10 people, the registered charity should then have two of its own representatives as members of the joint venture management committee

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b) Commentary

- A joint venture arrangement allows a smaller charity to participate with other, sometimes larger charities in a charitable project through the pooling of monies and resources
- Provided that the smaller charity has proportionate input into all of the planning, decision making and oversight of the project, its monies do not have to be segregated from those of the other joint venture participants (as is the case with agency relationships) but instead can be pooled together and used for the joint venture

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- Where the pooled monies from the joint venture are used to purchase real estate or other tangible assets, ownership of the said assets does not have to be retained by the Canadian registered charity
- However, it is often the case that the joint venture committee required to be established under the joint venture is either never established or, if it is initially established, then it is not maintained for the full term of the joint venture

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**Agency Relationships**

**a) Description**

- In an agency agreement, a registered charity can appoint an agent to act as its representative in carrying out specific tasks on behalf of the charity and, in doing so, transfers some of its charitable monies to the agent for the tasks
- Agents can be organizations or individuals and do not need to be qualified donees under the ITA or registered charities in their own countries
- Provided that the registered charity retains direction and control over the tasks being carried out by the agent, as well as the monies or other resources transferred to the agent, the tasks are considered to be the charitable activities of the registered charity itself

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- Appropriate agency agreements are required to be entered into between the registered charity (known as the principal) and the agent setting out the terms of the relationship
- Agency agreements can be one-time agreements or can be master agreements where there is to be a longer term relationship between the parties which are then supplemented by letter agreements accompanying each transfer of monies
- Sometimes an agency relationship may not be required. Review whether the CRA charitable goods policy may apply. (*Magen David Adom* decision)

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**b) Commentary**

- Agency arrangements are the most common method used by registered charities to carry on activities outside of Canada where it does not have its own employees and volunteers to do so
  - i. Practicality Concerns**
    - In order for the registered charity to retain control over the project or tasks being carried out by the agent, the monies or resources transferred to the agent have to be segregated.
    - There are strict reporting obligations by the agent to the registered charity
    - Having an agency agreement in place but not abiding by its terms may be grounds for deregistration (*Bayit Lepletot* case)

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**ii. Liability Concerns**

- It is a principle at law that a person may appoint a third party as his or her agent to act on his or her behalf
- In such situations, the actions of the agent are deemed to be actions of the principal and, as a result, the principal is thereby vicariously responsible for the actions of the agent
- This vicarious responsibility for the acts of its agent can then expose the registered charity (as principal) to significant liability, both civil and criminal (e.g. anti-terrorism legislation)

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- This concern is identified by the CRA in its guide entitled *Registered Charities Operating Outside Canada* at [www.cra-arc.gc.ca/E/pub/tg/rc4106/readme.html](http://www.cra-arc.gc.ca/E/pub/tg/rc4106/readme.html)

**iii. Insurance Concerns**

- Insurers may express concerns about the vicarious liability risks associated with agency relationships
- The liability risk of a charity that is associated with any of its agency relationships may not be covered by the charity's insurance policy unless fully disclosed to the insurer
- It is important for a charity to advise its insurer in writing of the nature and extent of its agency relationships to ensure there is proper insurance coverage for the agent's activities

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- As a result, for insurance purposes, it may be necessary that a project be undertaken through a contract for service arrangement instead of an agency contract

**iv. Financial Statement Concerns**

- By appointing agents to carry out a registered charity's charitable work, the assets provided to the agents for the identified projects would continue to be assets of the registered charity and would need to be reflected in its financial statements

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– It is for this reason that CRA requires agents to segregate funds provided to the agent by the Canadian registered charity from the agent’s own funds, and to keep separate books and records among other requirements

– However, in leaving these monies on the financial statements of the charity, it might result in a negative impact on future fundraising by the charity, as it might lead donors to believe that the charity has more funds available to it than it in fact has

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**v. Disbursement Quota Concerns**

– A registered charity in an agency relationship must comply with the normal ITA requirement to expend 80 percent of its receipted income in the previous year on charitable activities in the current year

– Assets provided to agents for identified projects will not be considered to have been expended for disbursement quota purposes until they are spent by the agent on direct charitable work

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**Contract for Service**

**a) Description**

- A registered charity can also carry out its charitable activities by contracting with an organization or individual in another country to provide specific goods and/or services
- Contractors can be organizations or individuals and do not need to be either qualified donees under the ITA or recognized charities in their own countries

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- For example, a Canadian registered charity with charitable purposes to advance religion may contract with organizations located in different countries to conduct religious activities in designated countries
- The registered charity is required to give precise instructions to its contractors
- This necessitates that a written contract be entered into between the parties which clearly sets out what the contractor is to do in return from the payment being received from the charity and the reporting obligations that the contractor has back to the charity

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b) Commentary

i. Liability

- The vicarious liability that exists between a registered charity and its agent in an agency relationship does not generally exist with a contract for service between a registered charity and the third party organization with whom they contract to provide services
- This is because the vehicle being utilized to effect the relationship is different, i.e. a contract versus a principal/agent relationship

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- Instead, any liability associated with the work being carried out by the third party contractor under the contract for service is generally limited to the said contractor under the contract and, therefore, does not extend back to the charity
- However, it is open to a plaintiff in a lawsuit being brought against a third party contractor and the charity to argue that the charity exercised too much day-to-day control over the activities of the contractor and, therefore, has liability for the actions of the contractor

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**ii. Financial Statement**

- 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

**iii. Disbursement Quota**

- Similar to the financial statements, once assets have been transferred to third party contractors 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 disbursement quota

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- This is the case even where the third party organization has not expended the said monies itself within the applicable fiscal year of the registered charity

**iv. Insurance**

- In contrast to the agency relationship, a contract for service may be more attractive to the insurer, as it does not generally involve vicarious liability for the actions of the third party contractor as is the case with an agency relationship

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**STRUCTURING OF ARRANGEMENTS WITH THIRD PARTIES**

**General Guidelines**

- By working with third parties using one of the above-referenced legal relationship, a registered charity can use its monies or other resources to carry out charitable activities both inside and outside of Canada
- However, for these types of arrangements to be accepted by CRA as the registered charity's own activities, the following must take place as set out in CRA's Guide T4106:

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- The charity must be reasonably assured that the organization or individuals can deliver the required services
  - All expenditures must be in accordance with the registered charity's own charitable purposes and will be used for charitable activities of the registered charity itself
  - There is an appropriate agreement entered into by the parties setting out the terms of their relationship
  - The registered charity provides specific instructions to organizations or individuals, when required
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- The charity must regularly monitor the program or project and can provide appropriate evidence of the progress of the program or project to CRA, when requested
  - Periodic payments are made on the basis of its monitoring of the program or project's progress and the charity has the right to discontinue payments, if necessary
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- Written Agreements**
- CRA's Guide RC4106 indicates that written agreements with third parties, whether they are agents, contractors, joint venture participants, or partners, would need to "typically include at least the following information":
    - Names and addresses of all parties
    - The duration of the agreement or the deadline by which the project must be completed
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– A description of the specific activities for which funds or other resources have been transferred in sufficient detail to outline clearly the limits of the authority given to the third party to act for the Canadian charity or on its behalf

– Provision for written progress reports from the third party of the Canadian charity’s funds or other resources, or provision for the charity’s right to inspect the project on reasonably short notice, or both

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– Provision that the Canadian charity will make payments by installments based on confirmation of reasonable progress and that the resources provided to date have been applied to the specific activities outlined in the agreement

– Provision for withdrawing or withholding funds or other resources at the Canadian charity’s discretion

– Provision for maintaining adequate records at the charity’s address in Canada

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– In the case of agency agreements, provision for the Canadian charity’s funds and property to be segregated from those of the agent and for the agent to keep separate books and records

– The signature of all parties, along with the date of signing and effective date, where applicable

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**OTHER RELATED ISSUES**

- Books and records of the registered charity to be kept in Canada
- Guidelines to be followed where registered charity transfers property in a foreign country
- Compliance with anti-terrorism laws both in Canada and in the country of the third party
- Other international agreements, such as association agreement, and trade-mark licensing

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