
APPLYING FOR FEDERAL INCORPORATION AND CHARITABLE STATUS

*By Esther S.J. Oh and Terrance S. Carter**

A. INTRODUCTION

This *Charity Law Bulletin* (“*Bulletin*”) provides a brief overview of the general steps that are required in order to incorporate a federal corporation under the *Canada Not-for-profit Corporations Act* (“CNCA”), and apply for registration as a “charity” under subsection 149.1(1) of the *Income Tax Act* (Canada) (the “ITA”). This *Bulletin* assumes that the charity will carry out its activities primarily in the Province of Ontario, and therefore this *Bulletin* provides some commentary on a few of the more important issues relevant to charities operating in that province. This *Bulletin* does not provide a complete summary of all issues to be considered when incorporating and applying for charitable status given the complexity of the requirements that may apply to an organization under the CNCA and the ITA. Organizations wanting to incorporate and apply for charitable status should work with their legal counsel to review and address all applicable issues.

This *Bulletin* will focus on the incorporation procedures to be undertaken pursuant to the current regime established by Corporations Canada under the CNCA. While charities operating across Canada will also need to consider other compliance issues including, but not limited to, extra-provincial registrations, privacy, fundraising, investment powers, as well as legal risk management issues, those legal issues are beyond the scope of this *Bulletin*. This *Bulletin* has been prepared using plain language as much as possible in order to facilitate understanding of the issues described in this *Bulletin* by those volunteers of

* Esther S.J. Oh, B.A., LL.B., is a partner, who practices charity and not-for-profit law. Terrance S. Carter, B.A., LL.B., TEP, Trade-Mark Agent, is the managing partner of Carters, and counsel to Fasken on charitable matters. The authors would like to thank Christina Shum, B.M.T., J.D., Student-at-Law for her assistance in preparing this Bulletin.

charities who may not necessarily have any legal background. As such, footnotes to authorities are not included, although references to resource websites are provided where appropriate.

B. INCORPORATION

1. Why consider incorporation?

There are several different legal forms through which a charity can be organized and carry out its activities, including an unincorporated association, a trust, and a corporation. A brief commentary concerning the various options is provided below in order to facilitate an understanding of the benefits of incorporation.

Unlike a corporation, an unincorporated association is not a separate legal entity and has no legal status apart from its members. An unincorporated association is essentially a contractual arrangement among a number of persons that establishes an organization to achieve the stated common purpose as reflected in the memorandum of association, constitution or other constating document, as the case may be. As a result, an unincorporated association exposes its members, in addition to its directors, to personal liability. Since an unincorporated association is unable to hold property in its own name, property needs to be held in the name of individuals acting as trustees for the unincorporated association. In addition, an unincorporated association is generally unable to sue, be sued, or enter into contracts on its own and would therefore require its members to do so in a representative capacity.

Trusts are created when one person or several people hold legal title to property, with beneficial ownership being held by another person or for charitable purposes. Trusts are usually established by a trust document or other instruments, and are commonly used for estate, tax, or charitable purposes. A trust arrangement requires the appointment of successive trustees and therefore does not have a permanent nature to it. Trustees can be exposed to a high degree of personal liability.

In contrast to an unincorporated association or a trust, a corporation is a separate legal entity independent of its members, officers, and directors. In this regard, a share capital corporation is utilized to operate for-profit businesses whereby the corporation is owned by its shareholders and

the purpose of the corporation is to generate profit. A non-share capital corporation, however, is generally used for not-for-profit purposes whereby the corporation is not owned by anyone but is governed by the members, officers and directors of the corporation, and generally without the intent of making a profit.

There are several advantages to incorporating an organization. In this regard, incorporation results in the perpetual existence of a separate legal entity, in contrast to an unincorporated association or a trust arrangement. Unlike an unincorporated association, a corporation can own property in its own right and can also bear liability for its own actions. A corporation can own, mortgage and lease land and all other assets in its own name without having to rely upon trustees or members to do so in a representative capacity on behalf of the corporation.

A corporation also provides the benefit of limited liability protection for its members, i.e. members of a corporation generally cannot be sued or held liable for the debts or liabilities of the corporation. While directors of an incorporated charity must still meet a high fiduciary standard of care and may be exposed to liability in that regard, the directors and the members of a corporation can take steps to adopt a by-law that can authorize the corporation to indemnify its directors and officers for claims made against them by third parties.

Incorporation will involve an initial one time start-up cost when undertaken with the assistance of legal counsel. The expertise available through legal counsel can be an important benefit to the corporation in the long-term by assisting in the establishment of an appropriate documentary foundation that will reflect the governance, operational, and other needs of the corporation. In addition, legal counsel can help to ensure that the necessary steps are taken to file appropriate annual corporate returns and notices whenever there is a change of directors, officers, or head office. Minutes of the corporate meetings of the members and the directors will also need to be maintained on an on-going basis.

In Ontario, incorporation of a non-share capital corporation can generally be achieved through either the provincial government, e.g. the Province of Ontario under the *Ontario Corporations Act* (soon to be replaced by the *Ontario Not-for-Profit Corporations Act, 2010*), or through the federal

government under the CNCA. This *Bulletin* focuses on the latter of the two options. While organizations are not legally required to be incorporated before applying to become a registered charity, many registered charities do proceed with incorporation to obtain the benefit of the advantages outlined above.

2. Steps to be undertaken in order to incorporate as a federal corporation

In order to apply for incorporation under the CNCA, it is necessary to submit the following documentation to Corporations Canada:

- ◆ A completed and signed copy of Form 4001 – Articles of Incorporation;
- ◆ A completed and signed Form 4002 – Initial Registered Office Address and First Board of Directors;
- ◆ A Canada-based NUANS corporate name search report confirming the availability of the desired corporate name; and
- ◆ A filing fee of \$200 if the application is filed online through Corporations Canada’s Online Filing Centre. Otherwise a \$250 filing fee if filing by email, fax, or mail;

By-laws do not have to be filed with the application for incorporation. However, the CNCA requires that the by-law be filed within 12 months after being confirmed by the members.

A brief explanation concerning some of the items that must be addressed in the articles of incorporation and general operating by-law are provided below.

a) Articles of Incorporation

The articles of incorporation are analogous to the birth certificate for a corporation, in that it sets out the date on which the corporation came into existence and also establishes the corporate purposes of the organization. Where a corporation intends to apply for status as a registered charity, the corporate purposes contained in the articles of incorporation must be charitable. In this regard, in order to qualify for registration as a charity with Canada Revenue Agency, Charities Directorate (“CRA”), both the corporate purposes contained in the articles

of incorporation and the day-to-day activities carried out in furtherance of those purposes must be charitable in accordance with applicable Canadian law.

To facilitate the drafting process, where possible, the purposes can be prepared with reference to the model objects and sample objects outlined in applicable policy statements available on the CRA website. Reference can also be made to the pre-approved objects available on the website for the Office of the Public Guardian and Trustee of Ontario (www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bullet2.php), which can also be helpful in drafting charitable purposes for federal corporations. A few additional comments concerning the requirements that must be met in order to qualify for charitable status in Canada are provided at section C of this *Bulletin*.

If the organization is a religious-based charity and wishes to confirm the importance of its statement of faith, the statement of faith may be included as a schedule to the articles of incorporation in order to assist in entrenching the importance of the statement of faith within the governing documents of the organization.

In addition to the statement of purpose of the corporation, other key items that need to be reflected in the articles of incorporation for a charity include: the name of the corporation; the province or territory in which the registered office will be situated; the classes of members that the corporation is authorized to establish, if applicable; any restrictions on the activities that the corporation may carry on; as well as a dissolution clause stating that in the event of dissolution or winding up and after payment of all of its debts and liabilities, the corporation's remaining property will be distributed to one or more charities in Canada that are registered as such under the ITA. Generally, it is recommended that the recipient charities be restricted to those that have similar purposes to those of the applicable charity. Once the articles of incorporation has been drafted, it must be signed by the incorporator(s).

b) General Operating By-Law

The general operating by-law usually sets out the governance structure for the corporation. As mentioned earlier, the by-law must be filed with Corporations Canada within 12 months of

being confirmed by the members and needs to be prepared in accordance with the provisions applicable to non-share capital corporations set out in the CNCA. Some of the key items that need to be included in the general operating by-law include: qualification requirements and procedures that apply to admission of members; qualification requirements and procedures that apply to election of directors; director terms and maximum terms; and notice requirements and quorum requirements that apply to meetings of members and directors, respectively; provisions regarding officers, as well as other matters.

Once the application for incorporation has been filed with Corporations Canada, the time required to process the application can range between a few business days if done online or up to 5 business days if filed by email, fax, or mail, subject to the processing times in effect at Corporations Canada. However, once the articles of incorporation have been issued, the date of incorporation will be the date on which Corporations Canada originally received the incorporation application. When incorporation has occurred through the formal issuance of articles of incorporation by Corporations Canada, it is necessary to confirm the structure of the corporation through the adoption of initial organizing resolutions which will confirm the first directors and members, adopt the by-laws, approve the banking resolution as well as address other standard corporate matters which need to be approved at the first meetings of the directors and members, respectively, and which resolutions should be signed by the relevant parties to confirm those matters have been completed. The corporation will also need to complete other miscellaneous filings and corporate matters including registration in the Province of Ontario under the *Corporations Information Act* by the filing of Form 2 – Initial Return/Notice of Change with the Ministry of Government and Consumer Services (“MGCS”), as well as ordering the corporate seal and minute book for the corporation.

Although a corporation may use names other than its corporate name in representations to the public, all operating business names must first be registered with the MGCS pursuant to the Ontario *Business Names Act*. Accordingly, the need for a business name registration with the MGCS should also be reviewed.

C. CHARITABLE STATUS

1. Charitable Status vs. Non-Profit Organization Status

As indicated earlier in this *Bulletin*, there are no shareholders who “own” a non-share capital corporation because the purpose of the corporation is not to earn money but is instead to fulfil its non-profit or charitable purposes. A non-share capital corporation is governed by the members, officers and directors of the corporation. From a tax perspective under the ITA, a not-for-profit corporation can either be a non-profit organization under s. 149(1)(l) of the ITA or a corporation that has status as a registered charity. As there is widespread misunderstanding concerning the difference between a “non-profit organization” (“NPO”) and a “charity,” a brief explanation concerning the differences between tax status as an NPO and a charity are provided below.

Generally speaking, under the provisions of the ITA, an NPO is a club, society or association organized and operated exclusively for any combination of the following purposes: social welfare; civic improvement; pleasure or recreation; or any other purpose except profit. In order to qualify as an NPO under s. 149(1)(l) of the ITA, a club, society or association must be both structured and operated exclusively for any combination of the above purposes. Examples of NPOs, *i.e.* organizations that are not charities, are sports clubs, service clubs, non-profit housing corporations and trade associations. NPOs are generally exempt from the payment of income tax both at the federal and provincial levels, although other tax issues may require further consideration.

For an organization to be registered as a charity, its purposes have to fall within one or more of the following general categories of charitable purposes as identified by the courts: the relief of poverty; the advancement of education; the advancement of religion; or other purposes beneficial to the community in a way that the law regards as charitable. There are two basic tax related advantages of being a registered charity. Charitable registration results in exemption from the requirement to pay income tax and additionally allows a registered charity to issue official donation receipts for gifts received. This reduces the individual donor’s income tax payable or the taxable income of a corporate donor.

In accordance with Ontario case law, directors of registered charities generally must not receive any direct or indirect remuneration from the charity. This is because directors of a charity are considered to have trustee-like duties for purposes of managing and investing the charitable property of a charity. They are therefore prohibited from receiving any direct or indirect benefit from the charity without court approval or authorization under the regulations made under the Ontario *Charities Accounting Act*. For further information reference can be made to the PGT Guidance entitled “Payments to Directors & Connected Persons”, available at www.attorneygeneral.jus.gov.on.ca/english/family/pgt/authorization_of_payments.html. Directors of charities can be reimbursed for reasonable out-of-pocket expenses incurred on behalf of the charity. The prohibition on receipt of direct or indirect remuneration by a director generally only applies to charities and does not apply to directors of NPOs.

Under the provisions of the ITA, there are three types of designations for registered charities: charitable organizations, public foundations and private foundations. The designation of a charity as either a charitable organization, a public foundation or a private foundation depends on its board composition, its source of funding and the charity’s activities. In order to qualify as a charitable organization, it must primarily carry on its own charitable activities. In addition, it will be important that a majority of the charity’s directors are at arm’s length relationships with each other, i.e. are not related by blood, marriage, adoption or close business ties, and that the charity does not receive more than 50% of its funds from a person or a group of persons who directly or indirectly controls the charity.

2. Applying for Charitable Status

In order to apply for charitable status, it is necessary to submit the following documentation to the CRA:

- ◆ a completed Application to Register a Charity Under the ITA (Form T-2050) that has been signed by two directors or officers of the applicant organization; the Form T2050 form is available at www.canada.ca/content/dam/cra-arc/formspubs/pbg/t2050/t2050-fill-17e.pdf and CRA’s instructions to complete the Form T2050, T4063 Registering a Charity for Income Tax

Purposes are available at <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4063.html>;

- ♦ a copy of the articles of incorporation and articles of amendment, if any; and
- ♦ signed and dated copies of all general operating by-laws for the applicant organization.

There is no filing fee payable in order to submit an application for charitable status with the CRA.

While most of the Form T2050 is relatively straightforward, there are several portions of the form that merit careful attention. In order to complete Part 4 – Financial Information on the Form T2050, the applicant organization needs to prepare a proposed first year budget that sets out the expected sources of income, e.g. income from individual donors, businesses, government grants, fundraising, and outline the intended expenditures. Since it is difficult to precisely determine anticipated income streams and expenditures, it is generally understood that the proposed budget developed for the first year of the applicant organization’s operations is intended to reflect best estimates in this regard.

A detailed statement of activities, describing the day-to-day programs to be carried out in furtherance of the purposes contained in the articles of incorporation also needs to be enclosed with the Form T2050. As indicated above, in order to qualify for registration as a charity with the CRA, both the purposes contained in the articles of incorporation and the activities carried out in furtherance of those purposes must be considered by the CRA to be charitable in accordance with applicable Canadian law. The statement of activities must reflect a detailed description of how the purposes will be achieved by illustrating the specific types of programs to be undertaken. For example, a charitable purpose that reflects the goal of alleviating poverty by providing foods to persons in need could have as an activity the operation of a weekly soup kitchen or daily food banks in order to assist low-income individuals in furtherance of that object. Information concerning the applicant organization’s assets and liabilities, as well as general information regarding anticipated fundraising activities to be carried on by the corporation also need to be described in the Form T2050.

The Form T2050 now has a privacy disclosure on the last page indicating that personal information is being collected under the authority of the ITA in order to validate the identity and contact information of directors, officers and authorized representatives of the applicant organization. The information will also be used as a basis for the indirect collection of additional personal information from other internal and external sources, which includes social insurance numbers, personal tax information, and relevant financial and biographical information, which may be used by the CRA to assess the overall risk of registration with respect to the obligations of registration as outlined in the Act and the common law.

The disclosure states that where the application for charitable status is approved, the CRA is permitted to make the T2050 form (including any attachments) and copies of the registration letter (including any conditions and warnings contained therein) available to the public, with the exception of the confidential information in Part 5 and Part 6 of the Form T2050. If registration is denied, the information will not be provided to the public. Personal information may also be shared with other government departments and agencies under information-sharing agreements, which may include RCMP, CSIS, as well as foreign governments and agencies in accordance with section 241 of the ITA.

The CRA privacy disclosure encourages applicant organizations to voluntarily inform directors and officers that their personal information has been collected and disclosed to the CRA for the application process. There is also a requirement that those signing the T2050 on behalf of the applicant confirm they have read the said privacy disclosure.

Subject to the current processing times in effect at the CRA, once an application for charitable status has been filed, processing of an application for charitable status can range between six to ten months for straightforward applicants, such as churches, synagogues, mosques and public foundations, or longer for unique applicants. More time may also be required to address any additional questions posed by the CRA on the application. For this reason, it is good practice to proactively include sufficient information within the application for charitable status in order to

ensure completeness in an effort to reduce questions from the CRA, which in turn can lead to processing delays.

Finally, once charitable status has been confirmed by the CRA, a copy of the articles of incorporation and related governing documents must be provided to the Public Guardian and Trustee of Ontario for their information and records.

D. OTHER CONSIDERATIONS

It is also important that charities establish on-going legal risk management procedures in order to identify areas of risk and protective measures that may need to be taken. The “Legal Risk Management Checklist for Ontario-based Charities” (condensed version), dated November 2018, available at www.carters.ca/pub/checklst/Charity-Checklist.pdf, contains helpful general guidelines. The checklist provides a summary of common legal risk management issues that should be considered and addressed.