
NONPROFIT CENTERS NETWORK DENVER, COLORADO

JUNE 4, 2013

CANADA RULES: LEGAL STRUCTURES, TAXATION, AND FINANCING


By Theresa L.M. Man
tman@carters.ca
1-877-942-0001

© 2013 Carters Professional Corporation

CARTERS

Carters Professional Corporation / Société professionnelle Carters
Barristers · Solicitors · Trade-mark Agents / Avocats et agents de marques de commerce
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

Toronto · Ottawa
Mississauga · Orangeville
Toll Free: 1-877-942-0001



BARRISTERS
SOLICITORS
TRADEMARK AGENTS

Nonprofit Centers Network

June 4, 2013

Canada Rules: Legal Structures, Taxation, and Financing

Theresa L.M. Man
tman@carters.ca
1-877-942-0001

© 2013 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001Ottawa Toronto Mississauga Orangeville
www.carters.ca www.charitylaw.ca www.anti-terrorism-law.ca

2

KEY ISSUES

- What legal structure to use - e.g., corporation, trust, unincorporated, partnership
- What tax status to use
 - Registered charities
 - Non-profit organizations (NPOs)
 - For-profit businesses
- Risk management and other issues – e.g., municipal taxes, leasing, third party use of facilities, insurance

www.charitylaw.cawww.carters.ca

3

A. SOCIAL ENTERPRISE?

- Rapid growth of “social enterprise”
- For example:
 - UK - Community interest companies (CICs)
 - US - Low-profit limited liability companies (L3Cs)
- Canada
 - BC - Community contribution companies
 - Nova Scotia - Community interest companies

www.charitylaw.cawww.carters.ca

4

- In Canada, the mere fact that an activity is for a social good and is referred to as a social enterprise or social finance, or benefits community capacity building, does not necessarily mean that the activity is charitable
- Depends on the activity in each case
- CRA's Guidance CG-014, *Community Economic Development Activities and Charitable Registration*, July 26, 2012
<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/cmtycnmcdevpmt-eng.html>
- Community Economic Development ("CED") generally refers to activities that improve economic opportunities and social conditions of an identified community

www.charitylaw.ca

www.carters.ca

5

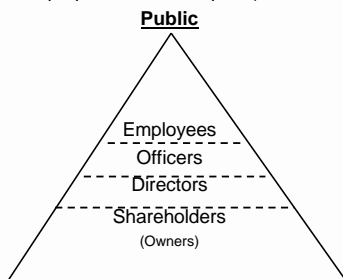
- CED activities are often referred to as "social enterprise" or "social finance", but they may not necessarily be CED activities for purposes of the Guidance
- The *Income Tax Act* ("ITA") has not been amended to provide corresponding tax relief to these hybrid forms of corporate vehicle
- These hybrid corporations (BC and NS) will continue to operate within existing framework in the Act, such as operating as for-profit entities, tax-exempt non-profit organizations, registered charities, and various combinations and structures utilizing these vehicles

www.charitylaw.ca

www.carters.ca

6

- Share capital corporations (business purpose to make a profit)



www.charitylaw.ca

www.carters.ca

7

- Non-profit organizations

Public

Employees & Volunteers
Officers
Directors
Members
(non-owners but often beneficiaries)

www.charitylaw.ca www.carters.ca

8

- Charities
(charitable purpose akin to a public trust)

Public

Employees & Volunteers
Officers
Directors
Members
(non-owners but accountability group for the charitable purpose)

www.charitylaw.ca www.carters.ca

9

B. REGISTERED CHARITIES

- At common law a charity includes an organization established for one or more of the following recognized charitable purposes:
 - Relief of poverty
 - Advancement of education
 - Advancement of religion
 - Other purposes beneficial to the community recognized by the courts
- Must devote all of its resources to engage in exclusively charitable activities to further exclusively charitable purposes

www.charitylaw.ca www.carters.ca

10

- Advantages of being a charity
 - No tax on income or capital gains
 - Can issue charitable donation receipts to donors
 - A gift for income tax purposes permits donor to receive a partial benefit (split-receipting)
- Disadvantages of being a charity
 - Must go through a registration process
 - Subject to more regulatory oversight
 - If charitable status is lost, subject to 100% tax unless give all assets to another qualified donee (e.g., another registered charity)
- Legal forms for a charity
 - Unincorporated associations
 - Charitable trusts
 - Corporations

www.charitylaw.ca www.carters.ca

11

Umbrella Organizations Guidance

- CRA's Guidelines for the Registration of Umbrella Organizations and Title Holding Organizations, CPS-026, May 1, 2008
<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-026-eng.html>
- Umbrella Organization - works to achieve a charitable goal by supporting, improving, and enhancing the work of groups involved in the delivery of charitable programs

www.charitylaw.ca www.carters.ca

12

- Three types of umbrella organizations
 - A. Promote the efficiency of Canadian registered charities ("Efficiency Umbrella Organization")
 - B. Work through a network of registered charities and non-registered entities to achieve a recognized charitable purpose ("Network Umbrella Organization") - not relevant for presentation today
 - C. Hold title to property on behalf of other registered charities ("Title Holding Umbrella Organization")

www.charitylaw.ca www.carters.ca

13

Type A Efficiency Umbrella Organizations

- Promoting the efficiency and effectiveness of other registered charities
- Activities that
 - Improve the efficiency of charities by increasing the amount of resources dedicated directly to charitable programs - e.g., by reducing the amount of overall charitable property contributed to operational costs and administration
 - Improve the effectiveness of charities by increasing the capacity of charities to deliver programs and serve individual beneficiaries - e.g., by providing assistance and expertise

www.charitylaw.ca www.carters.ca

14

- At least 90% of its services benefits other registered charities
- Can target its activities at improving the services of other registered charities, and can focus on improving most aspects of the beneficiary groups (e.g., direct delivery of charitable programs, planning fundraising campaigns, human resources)

www.charitylaw.ca www.carters.ca

15

- Examples of activities
 - providing a facility at no-cost or at reduced-cost to house the activities of registered charities
 - holding title to property on behalf of registered charities (See type C)
 - providing specialized administrative services (such as a website) or professional consulting services
 - providing training on a variety of topics for managers, staff, and volunteers
 - purchasing goods and services on behalf of a group of registered charities
 - generating, collecting, and disseminating data of interest and of use to registered charities

www.charitylaw.ca www.carters.ca

16

Type C Title Holding Umbrella Organizations

- Acts as a holding company for property beneficially owned by another related registered charity
- Can carry on varying degrees of activity
 - Least "active" - simply hold title to the property of another registered charity
 - May also provide other services, e.g.,
 - Property management services
 - Other support services
 - Securing and developing additional properties to be used for charitable purposes

www.charitylaw.ca www.carters.ca

17

- Not simply a landlord organization that owns a facility, which it leases, rents, or allows the use of by other, generally unrelated registered charities
 - Perhaps type A umbrella organization
 - Perhaps not an umbrella organization - related business or passive investment?

www.charitylaw.ca www.carters.ca

18

Related Business

- Charitable organizations and public foundations may carry on related businesses; Private foundations cannot carry on any business activities
- CRA's CPS-019 "What is a Related Business" <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.html>
- If non-compliance
 - Penalty of 5% of gross revenue from the activity on first offence
 - Repeat offence in 5 years: 100% penalty and suspension of receipting privileges
 - Revocation of charitable status
- Two types of related businesses
 - Substantially run by volunteers
 - Linked and subordinate to a charity's purpose

www.charitylaw.ca www.carters.ca

19

(1) Substantially run by volunteers

- “Related business” is defined in the ITA to “include” a business that is unrelated to the objects of the charity if it is run substantially (90%) by volunteers
- Based on head count
- People “employed” means the people the charity uses to operate the business
- Includes both employees and independent contractors
- Therefore, as long as the business is run by volunteers, the charity can engage in most types of business activity, regardless of scale

www.charitylaw.ca www.carters.ca

20

(2) Linked and subordinate to a charity’s purpose

- Four forms of linkage
- A usual and necessary concomitant of charitable programs - e.g., hospital parking lots, gift shops
- An off-shoot of a charitable program - e.g., church selling recording of special Christmas services hosted by its famous choir
- A use of excess capacity - e.g., university renting out residence facilities in summer months
- Sale of items that promote the charity or its objects - e.g., sale of pens, credit cards, and cookies that clearly display the charity’s name or logo, and T-shirts or posters

www.charitylaw.ca www.carters.ca

21

- Factors of subordination to a charity’s purpose
- The business activity receives a minor portion of the charity’s attention and resources
- The business is integrated into the charity’s operations (not acting as a self-contained unit)
- The charity’s charitable goals continue to dominate its decision-making
- The charity continues to operate for an exclusively charitable purpose, not permitting any private benefit

www.charitylaw.ca www.carters.ca

22

Investment

- Deriving income from investments - not business activity
 - Investment income is derived primarily from the *mere ownership of the asset* - not dependent on active trading or the exploitation of the asset
 - The risk to the charity is generally limited to the *purchase price of the asset*
 - A *passive activity*, in that it does not call upon the charity to take any active role in operating the underlying business
- Has to comply with provincial legislation, e.g., trustee legislation

www.charitylaw.ca www.carters.ca

23

C. NON-PROFIT ORGANIZATIONS (NPOS)

- Paragraph 149(1)(l) of the ITA - 4 basic requirements
 1. Not be a charity
 2. Be organized exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit
 3. Be operated exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit
 4. Not distribute or otherwise make available for the personal benefit of a member any of its income

www.charitylaw.ca www.carters.ca

24

- Advantages of being an NPO
 - Generally tax-exempt - Do not pay tax on income or capital gains, unless its main purpose is to provide dining, recreation or sporting facilities
 - Broader possible purposes than a registered charity - any purpose other than profit
 - More freedom to operate vis-a-vis tax rules in the ITA than registered charities
 - No requirement to register with CRA and many do not even file a tax return
 - Can pay directors

www.charitylaw.ca www.carters.ca

25

- Disadvantages of being an NPO
 - Must not otherwise be a charity
 - Cannot issue donation receipts
 - Cannot be organized or operated to make a profit
 - No income to its members
 - Cannot accumulate excess funds each year beyond its reasonable needs
 - If NPO status is lost, it would become taxable
- Legal forms for NPOs
 - Unincorporated associations
 - Corporations
- Recent CRA views create much uncertainty for NPOs and substantially limit their revenue-generating capacity

www.charitylaw.ca www.carters.ca

26

- It is a question of fact that can only be determined after a review of the purposes and activities of the NPO
- NPO status must generally be reviewed on a year by year basis
- Being incorporated as a not-for-profit under corporate legislation does not mean that the organization is an NPO for tax purposes
- See CRA *IT-496R, Non-Profit Organizations*
<http://www.cra-arc.gc.ca/E/pub/tp/it496r/README.html>

www.charitylaw.ca www.carters.ca

27

- NPOs must be *operated* exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit
- This criteria is the subject of the most uncertainty for NPOs
- Summary of CRA's view
 - May receive incidental profits through basic fundraising (lotteries, bake sales, chocolate bar sales, etc.) and soliciting gifts and grants
 - Can earn profits, but the profits should be incidental and arise from activities that are undertaken to meet the organization's not-for-profit objectives ("incidental profits")

www.charitylaw.ca www.carters.ca

28

- Earning profits to fund not-for-profit objectives is not considered to be itself a not-for-profit objective (i.e., no destination test)
- Should fund capital projects and establish (reasonable) operating reserves from capital contributed by members, from gifts and grants, or from accumulated, incidental profits
- Capital contributions, gifts and grants, and incidental profits should generally be accumulated solely for use in the operations of the organization (including funding capital projects or setting up operating reserves) and should not be used to establish long-term reserves designed primarily to generate investment income

www.charitylaw.ca www.carters.ca

29

- Maintaining reasonable operating reserves or bank accounts required for ordinary operations will generally be considered to be an activity undertaken to meet the not-for-profit objectives of an organization - incidental income arising from these reserves or accounts will not affect the status of an organization
- May engage in limited fundraising activities involving games of chance (e.g., lotteries, draws), or sales of donated or inexpensive goods (e.g., bake sales or plant sales, chocolate bar sales)
- The earning of income must not be an operating motivation and it must not be the focus of the activity of the organization

www.charitylaw.ca www.carters.ca

30

D. FOR-PROFIT BUSINESS

- Advantages
 - More freedom to engage in activities
 - Can pay directors
 - Can attract equity investment
- Disadvantages
 - Taxable (but can claim charitable deductions up to 75% of its net income)
 - Can claim deductions from sponsorship and advertising, but must be reasonable in the circumstances
 - Cannot issue donation receipts

www.charitylaw.ca www.carters.ca

E. CONCLUSION

- Which option to use will depend on the facts in each case, e.g., the goal to be achieved, what other entities will use the facility
- No one size fits all solution
- Each one has pros and cons



BARRISTERS
SOLICITORS
TRADEMARK AGENTS

Disclaimer

This handout is provided as an information service by Carters Professional Corporation. It is current only as of the date of the handout and does not reflect subsequent changes in the law. This handout is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2013 Carters Professional Corporation
