TIDES CANADA INITIATIVES SOCIETY: CHARITABLE VENTURE ORGANIZATIONS: A NEW INFRASTRUCTURE MODEL FOR CANADIAN REGISTERED CHARITIES

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INTRODUCTION

In 2008, the Tides Canada Initiatives Society (TCI) began a project to consider a model support structure for charitable activities that is variously and perhaps erroneously termed "fiscal sponsorship," a support or "umbrella" organization, or a "facilitator" organization. None of these terms adequately describes the multi-faceted structures that currently exist in Canada in support of Canadian registered charities, nor are the operational and compliance issues appropriately addressed.

The TCI project has two phases. The first phase culminated in a Consultation Paper seeking the views of the public on our tentative recommendations regarding the new model. The second phase, built upon the recommendations and the responses we received from the public, involved a series of consultations in Toronto and Vancouver and the publication of this report.

The project was made possible by grants from the Law Foundation of British Columbia and the Law Foundation of Ontario.

BACKGROUND

Scope and Objectives of Project

TCI initiated this project with the intention of advancing the development of the Canadian legal and regulatory framework to support and promote an innovative model that provides comprehensive infrastructure, organizational, and governance supports for emerging charitable activities, for projects with limited mandates, and for community coalitions and international charitable organizations seeking a "home in Canada."

More specifically, TCI's objectives are:

(i) to introduce the concept of a "charitable venture organization" (CVO) in order to create a common language and provisional framework for a phenomenon that already exists in various forms in the Canadian voluntary sector; and

(ii) to propose the creation of "good practice" guidelines that will enable CVOs to operate in compliance with existing legislation.

Methodology

TCI developed a working hypothesis for the model described above with the assistance of David Stevens of Gowlings, Lafleur Henderson LLP in Toronto and Margaret Mason of Bull, Housser & Tupper LLP in Vancouver. The hypothesis – that this model could bring efficiency to, and increase the program delivery capacity of, the voluntary sector – was tested at two roundtables, one in each of Vancouver and Toronto, with legal practitioners with expertise in matters of concern to charities and not-for-profit organizations in Canada. Mason and Stevens distilled the roundtable discussions into a Consultation Paper, adding a technical analysis, a description of a number of different models that may be "scalable," and some recommendations regarding best practices.

The Consultation Paper was then tested among selected legal practitioners and sector representatives and culminated in a half-day session in Toronto with a wide-ranging group of individuals representing all facets of the voluntary sector (see Appendix A). These consultations and discussions are distilled in this report.

Needs of the Canadian charitable sector

In the Charities Directorate of the Canada Revenue Agency's (the CRA) Newsletter No. 31 published in 2008, the CRA noted that on an annual basis it processes approximately 4,500 applications for charitable status and that, provocatively, as many as 2,200 charities lose their registered status each year because they cease to operate or fail to file their required annual information return. The CRA goes on to raise a number of questions with respect to why so many charities "fail."

We believe that part of the answer to these questions is the outdated infrastructure model that leads many who wish to initiate a charitable project or endeavour to the unfortunate conclusion that they must establish a stand-alone registered charity, whether or not they have the organizational or operational skills to govern an organization, collect and properly record financial information, hire and supervise employees, or deal with the intricacies of compliance with the disbursement quota rules described in the *Income Tax Act* (Canada) (the "Act"). This is neither effective nor efficient.

An organizational model is needed that would:

- be a home for social innovation, providing the space for experimention, allowing for projects to accomplish discrete goals, and enabling inclusive participation in the charitable sector for small grassroots groups and initiatives that may be kept out of the sector for lack of administrative expertise or financial resources, or unfamiliarity with regulations and requirements.

- lead to improved quality by providing access to experts, ensuring data reliability, promoting transparency, advancing accountability, and helping to ensure good practices in charitable reporting, accounting, and grants management so that projects need not spend so much time on back-office administration and can instead focus their time and energy on their programs, resulting in stronger outcomes.

- provide economies of scale through the sharing of an existing infrastructure for finance, administration, human resources, governance, compliance, and risk management, thus eliminating the need for projects to invest precious resources in duplicating this infrastructure.

- manage risk by furnishing all participants with comprehensive personnel policies, liability insurance, and forms and training on new government regulations, thereby ensuring the capacity to meet governance and compliance obligations and thus significantly reduce risk.

- promote shared learning by identifying and encouraging inter-agency collaboration and merger opportunities, creating opportunities to increase cohesion among projects, disseminating good practices, providing a professional development track, facilitating peer-to-peer learning among projects, and supporting informed decision making regarding various organizational options for communities as they develop new initiatives and collaboratives.

The Model

One of the difficulties inherent in this project is coming up with a description that encompasses the breadth of the different structures used in Canada to provide the support and services described above.

TCI believes that the infrastructure model under which it currently operates is an exemplar worthy of consideration (the "TCI Model"). TCI is a registered Canadian charity and in type, a "charitable organization." As such, the requirements of the Act push TCI to conduct primarily its own charitable activities although it is not prohibited from granting to "qualified donees" as defined in the Act.

In operational terms, the TCI Model encompasses the following: internally generated projects performed by TCI employees or contractors, externally generated projects "adopted" as TCI projects and performed by TCI employees or contractors, and the housing of community collaborations. All support services including accounting, financial, human resources, telephone, e-mail/Internet/website, and regulatory compliance are provided by TCI. A portion of TCI's administrative overhead cost for such support is allocated to each project, and each project must generate sufficient revenue to cover its expenses. In essence, each project is unitized within TCI. Short-term projects generally stay within TCI for their duration; longer-term projects may develop sufficient capacity to transition to a stand-alone entity separate from TCI.

The roundtables could not agree on a single "pithy" term that defined the model. "Fiscal sponsorship," a term in common use in Canada that was imported from the U.S., was thought to be inadequate in the Canadian context and undesirable because it breeds misinformation in that, in essence, it suggests the opposite of the actual responsibilities of the "hosting" organization and the project. It mistakenly implies that the host is simply a conduit of funds to those who actually perform the project. In the Canadian context, such a relationship must be structured so that the host owns and operates the project and controls all aspects of funding and performance. The proposed model is not simply that of a "hub"

that provides services to existing entities, although it encompasses elements of such a relationship. It is not an "incubator" or "accelerator" model that serves to get started projects that eventually become independent. Nor is it exclusively a "program" sponsor model in which an organization agrees to accept projects within its infrastructure.

We debated numerous names for an organization under the proposed model, including "charity infrastructure organization," "fiscal and capacity support organization," and "charitable sector support entity." We suggest the term "charitable venture organization" and its acronym "CVO" as the most encompassing and descriptive name for this model.

Why change is needed

There is a strong need to create a framework and common language in Canada that accurately describes this work and the charitable venture organization model. There is also a need to eliminate language that is inappropriate and unhelpful and that leads to misunderstanding and non-compliance.

It is also clear that there is a deep need for organizations in Canada that provide this infrastructure, particularly for not-for-profit groups without charitable status that operate through agency agreements and for unincorporated groups that operate as projects of a charitable venture organization. It is our view that this model and the variations that encompass parts of it will lead to greater effectiveness and efficiency in the sector, thus decreasing the unceasing duplication of administrative costs, reducing the number of charities that are registered and de-registered each year, increasing capacity and professionalism in the charitable sector, and increasing compliance with the Act.

"Fiscal sponsorship" is the most commonly used term for this model, but this leads to misunderstanding in the sector of the fundamental structure currently imposed by the Act. As currently understood, a not-for-profit-organization that wishes to conduct a project will typically have connected with a donor who supports the project but wishes a donation tax receipt for doing so. The not-for-profit then seeks out a "fiscal sponsor," in other words, a registered charity with congruent purposes, which is expected to agree to accept the gift from the donor, issue a donation tax receipt, and then to simply transfer the funds to the not-for-profit for its project. This is technically problematic on two fronts: firstly, a registered charity is only entitled to issue a donation tax receipt for gifts to the charity itself, but this purported gift is not a gift to the charity but to the not-for-profit; and, secondly, the charity has made a prohibited gift to a non-qualified donee. Operating in this manner leaves a registered charity exposed to sanctions in the Act, the most severe of which is loss of charitable registration.

When an enthusiastic not-for-profit is advised that "fiscal sponsorship" is not possible but that a charity could, instead, take ownership of the project (and all that flows therefrom) and engage the not-for-profit, or perhaps individuals associated with it, to perform the project, the required relinquishment of control over the project (and its product) frequently makes the relationship untenable. If the charitable venture model were more deeply understood, both parties would enter into the relationship with appropriate expectations, which would then allow the project or service to be performed with the hope of achieving a public good.

We also suggest that the more widespread use of the charitable venture model will result in the strengthening or "professionalization" of organizations in that grassroots groups and initiatives will come within an established organizational structure that models appropriate governance at the board level, has financial and other systems in place, and has the ability to demonstrate the skills and behaviours of successful organizations.

The lack of a defined and consistent understanding of the CVO model in Canada and the corresponding need for sophisticated governance to ensure compliance with the Act increase the risk of organizations engaging in this type of work without the capacity to do so. An ineptly managed "fiscal sponsorship" or program performance relationship raises questions of compliance with the Act. For example, if the program performance relationship is sloppily managed, or if the contractor performing the program does not appreciate the technical requirements and promotes "its" program on its website, this increases the risk of the charity's loss of charitable registration for failing to exercise sufficient direction or control over its activities. Risk management is also an issue with respect to employees and contractors, insurance, and liability for tortious acts. How does the charity deal with the potential severance liabilities of an employee taken on for a specific project when the project is completed? How does the charity deal with the ownership and licensing of intellectual property created by a project which then becomes an independent organization seeking to carry on the same work?

While the CRA acknowledges in some of its publications the existence of organizations that function in a way that is similar to the CVO model (see for example CPS – 026 Guidelines for the Registration of Umbrella and Title-Holding Organizations), such organizations can be challenging to register because of the diffuse nature of their purposes and proposed activities. Use of the CVO model would become more widespread if the model was conceptually better understood and integrated in the Canadian charitable landscape.

TECHNICAL ISSUES: COMPLIANCE WITH THE ACT

Introduction

One of the unfortunate characteristics of the Canadian regulation of charities is that the rules in the Act are sparsely stated. Another is that the rules have been built up over several major and a number of minor legislative reforms that have not, for the most part, paid sufficient attention to policy coherence or logical flow in the Act. This has led to a regulatory regime that is both conceptually complex and vague and highly susceptible to administrative discretion.

In response, the CRA has exercised its administrative discretion in a very cautious but nonetheless inordinately influential way, often proscribing activities for which no clear legislative prohibition is stated or implied. The courts have not had much occasion to address many of the issues as very seldom do registered charities have the resources to litigate their claims for a different, more liberal interpretation of the legislation. However, when the courts have considered such issues, they have tended to express views that are more in line with the CRA's conservative positions than with those hoped for by the sector.

In a number of areas, this mix of legislative lethargy and administrative caution has made the operations of charities extraordinarily difficult. One area where this is particularly true is in the collaboration of a registered charity with an entity that is not a registered charity. This type of collaboration happens almost automatically when a registered charity wishes to conduct operations outside Canada. The registered charity will invariably need to collaborate with a foreign charity, which will not, of course, be a registered charity, given that Canadian residency is required. It should be noted, however, that the problem also arises in a purely Canadian context since there are many worthwhile charitable projects that, for one reason or another, require collaboration with an entity that is not a registered charity.

This section of the report describes the Income Tax Act provisions, as interpreted and applied by the CRA, that are applicable to domestic collaborations between registered charities and entities that are not registered charities.

The basic framework: The Act

The Act divides registered charities into two main types: "charitable organizations" and "charitable foundations." "Charitable organization" is defined, in part, as "an organization all of the resources of which are devoted to charitable activities carried on by the organization itself." A charitable organization is deemed to be devoting its resources to its own activities if it distributes not more than 50% of its income to "qualified donees" (as further discussed below). Thus, a charitable organization may carry on its own activities or may make grants to "qualified donees," subject to the 50% limit.

"Charitable foundation" is defined as "a corporation or trust that is constituted and operated exclusively for charitable purposes" and that "is not a charitable organization." A charitable foundation may devote all of its resources to making grants to "qualified donees" should it wish to do so. A charitable foundation is not, however, limited exclusively to granting to "qualified donees" and may conduct programs.

All registered charities are subject to a disbursement quota. All registered charities must disburse each year an amount equal to 80% of the previous year's receipted donations (and at least 80% of gifts received from other registered charities) and 3.5% of a rolling two-year average of the value of, in effect, their investment assets. These amounts must be disbursed in the organization's or the charitable foundation's own activities, or as grants to "qualified donees."[1]

Prior to recent amendments to the Act, it was possible for a registered charity, once it had satisfied its disbursement quota, to make grants to entities that were not "qualified donees," including foreign charities. The only legislative provision that applied was the requirement that the activities of the recipient entity be exclusively charitable in the common law sense. This rule could therefore be satisfied if grants were made to entities whose activities were exclusively charitable, even if they were not qualified donees. The Act was amended (effective December 20, 2002) to provide that making a grant to an entity that is not a qualified donee is now grounds for deregistration.

Subsections 188.1(4) and (5) of the Act impose intermediate sanctions on registered charities that make gifts to non-qualified donees. For a first offence, the penalty is 105% of the

amount of the benefit conferred. A subsequent offence committed within five years is subject to a penalty equal to 110% of the benefit conferred. Making gifts to non-qualified donees could also result in deregistration. The decision about whether to begin with intermediate sanctions or to go directly to revocation is exclusively in the purview of the CRA.

"Qualified donee" is defined in subsection 149.1(1) of the Act by reference (in part) to the definition of "total charitable gifts" and "total crown gifts" contained in subsection 118.1(1). These latter definitions are lists that include the following entities: a Canadian registered charity, the Crown (federal, provincial or municipal), the United Nations or an agency thereof, a university outside Canada with a student body ordinarily comprising Canadian students, and a charitable organization outside Canada to which Her Majesty in Right of Canada has made a gift during the individual's taxation year or the 12 months immediately preceding that taxation year. The list of eligible foreign universities is set out in Schedule VIII of the Act. The reference there is to these universities only, not to their related or affiliated foundations, or other charities associated with them.

As can be seen, the scope for foreign giving and foreign activity by registered charities is very limited. Similarly, the opportunities for a Canadian registered charity wishing to collaborate with an entity that is not a qualified donee, domestically or otherwise, are severely limited.

CRA Guidance – Models of Collaboration

STATEMENT OF THE CRA'S VIEWS

RC4106 "Registered Charities: Operating Outside of Canada" (October 16, 2000) provides a detailed description of the CRA's views on how Canadian charities may operate abroad and, by necessary implication, domestically with non-qualified donees. [See Appendix B for a discussion of the case law on which the CRA bases its views.]

The CRA recently issued a consultation on a revised version of this guidance. The new guidance is contained in a consultation paper entitled Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities (the CRA Consultation Paper). The final version has not yet been issued.

In the CRA Consultation Paper, the CRA emphasizes the requirement that a charity exercise direction and control over its property:

> The Act requires a charity to devote all its resources to charitable activities carried on by the charity itself (which includes making gifts to qualified donees). As confirmed by the courts, this means a charity must control all activities carried out on its behalf, and not act as a passive funding body for any other organization that is not a qualified donee.
>
> A charity can carry on its activities through its staff (for example – volunteers, directors, and employees) or through intermediaries. In this guidance, an intermediary is defined as a person or non-qualified donee that is separate from the charity, but that the charity works with to carry out its own activities.

On the basis of the foregoing, the CRA "strongly recommends" that a charity put a written agreement in place when working through an intermediary. However, the CRA is quick to add that a written agreement is just the beginning:

> A charity must be able to show that in fact, at all times, it is carrying out only its own activities through the intermediary, and that it directs and controls the use of any resources that further these activities. For a charity to show that it is carrying on its own activities, it must be able to show the CRA the following:
>
> • a clear, complete, and detailed description of the activity, as well as detailed information on how, when, and where it is carried out;
> • records demonstrating that clear, complete instructions and directions in relation to the activity are, or will be, provided to those who carry it on;
> • records showing that it monitors and supervises the activity on an ongoing basis;
> • documentary evidence that it deals with relevant issues related to the activity; and
> • books and records that verify that the charity's funds have been spent on its own activities.

The *CRA Consultation Paper* identifies several collaboration models but provides little in terms of practical administrative guidance to assist a charity in determining whether any of such models is practical for them.

> • **Agency:**
> Agents are individuals or organizations who are separate from a charity but who agree to carry out specific activities on its behalf. A charity often uses agents when it cannot send its employees or volunteers to a particular region to carry out an activity. …
>
> A charity working with an agent must always be able to show that the agent is carrying on the charity's own charitable works.
>
> • **Joint Venture:**
> A joint venture participant is an organization that a charity works with to carry out a charitable activity. The charity and one or more joint venture participants pool their resources in order to accomplish their goal under the terms of a joint venture agreement.
> A joint venture participant differs from an agent in that the charity is not relying entirely on the joint venture participant to carry out activities on its behalf. Instead, the charity works directly with a joint venture participant to further the charitable activity as a whole.
> Typically the charity would have members sit on the governing board for the entire project, allowing it to make decisions on the use of the charity's resources for the project. The actual structure of a joint venture varies from case to case.
>
> The charity must be able to establish that its share of authority and responsibility over the joint venture as a whole is at least proportional to the level of resources it contributes. A charity that exercises limited decision-making authority over

the venture as a whole may have difficulty establishing that it is carrying on its own activities.

- **Co-operative Participant:**

A co-operative participant is an organization that a charity works with, side by side, to complete a charitable activity. Rather than pooling their resources and sharing responsibility for the project as a whole, as in a joint venture, the charity and other organization(s) instead each take on responsibility only for parts of the project.

- **Contractors**

A contractor is an organization or individual that a charity hires to provide goods or services. For example, a charity might hire a for-profit company to dig a well for people lacking clean drinking water in a foreign country.

The CRA strongly advises charities to make sure that their contractors are reputable and able to deliver the goods or services required. A written contract should be put in place between a contractor and a charity, stating the goods or services to be provided, the fee to be paid by the charity, and arrangements for inspection and monitoring.

In this guidance, co-operative participant means an organization that a charity collaborates with to achieve a common, charitable purpose. It is not meant to create or imply any special legal status between the organizations.

From the CRA's perspective, the two key concepts are "own activities" and "control and direction." Regarding the former, the CRA Consultation Paper states:

> To meet their own activities test when working through an intermediary, a charity must actually and in fact control the activities carried out on its behalf. [Footnote 18] For example, the charity (and not the intermediary) must be the body that decides, and exercises ongoing control over, how an activity will be carried out, its overall goals, where it is carried out, who benefits, which goods and services its money will buy, and when it will start and end.
>
> A charity cannot act as a passive funding body for a non-qualified donee's activities, even if the non-qualified donee's activities are charitable under Canadian law. If a charity passively funds a non-qualified donee's programs, that charity is acting as a conduit.

On the latter, it states:

> A charity must always be the body that determines how its money and other resources are used.
>
> The surest and safest way to control and direct its resources is for a charity to use its staff to carry out its activities. That way, the staff can be sure the charity's resources are used only for its charitable purposes, such as by distributing food directly to the hungry, or by building housing for the homeless.

However, if a charity cannot use its staff to transfer its resources to those in need, it will likely have to rely on an intermediary. In these situations, a charity must be extremely careful to maintain direction and control over the use of its resources by the intermediary. If a charity transfers its resources to an intermediary, and that intermediary decides to use the resources for purposes that are not the charity's own, the charity will fail the own activities test and be in violation of the Act.

A charity should always have an agreement in place with any intermediary. An agreement will ensure direction and control over the use of a charity's resources, to make sure that they are only used to carry out the charity's own activities. The nature of the agreement will depend on the situation. In some cases the agreement may only require a verbal discussion of what will happen with the resources, while other situations will call for all of the measures of control discussed below in the following sections:

Written agreements
Description of activities
Monitoring and supervision
Ongoing instruction
Periodic transfers
Separate activities and funds

- **Charitable Goods Policy.**

In certain limited situations, the CRA accepts that goods of a "charitable" nature may be given to non-qualified donees. This is referenced in the CRA's charitable goods policy.

The Federal Court of Appeal in the Magen David Adom decision (see Appendix B) did not come to a clear conclusion that the CRA's charitable goods policy is valid as a matter of law. However, the CRA, in its Registered Charities Newsletter No. 20, September, 2004, has confirmed that in its view the charitable goods policy is valid:

> The Charities Directorate will consider a transfer of property reasonable where the nature of the property means that it can be used for a charitable purpose. For example, it is generally reasonable to assume that a copy of the Bible will be used for religious activities, and medical equipment will aid the sick, and that student books will be used for educational purposes in a school. In some cases, where the property could be used for something other than charitable purposes, it may nonetheless be unreasonable to expect the charity to maintain control of its assets. The Charities Directorate will consider such situations on a case by case basis only when requests are received in writing.

A Canadian charity relying on the charitable goods policy should still be in a position to show, based on its records, that its goods were charitable goods and that they were appropriately distributed.

A copy of the policy is provided in the *Magen David Adom* decision:

RE: Transfer of Goods and Services to Non-Qualified Donees

> Section 149.1 of the Income Tax Act allows a registered charity to operate in two different ways: other [sic] by devoting its resources to charitable activities carried on by itself and/or by gifting to qualified donees. The inference sometimes drawn from this is that therefore gifts or other transfers to non-qualified donees can never be made by registered charities.
>
> Such, of course is not the case. Gifts - and other transfers of goods and services - are often made by registered charities to non-qualified donees in complete compliance with the Act. Scholarships to students, assistance to the needy, salaries for the charity's employees, and payments for goods received are all examples of transfers of resources to non-qualified donees which are quite legitimate. They are transfers made in furtherance of charitable purposes and, more importantly, the expenditures are, themselves, evidence of charitable activities. The issue therefore, when determining whether a particular expenditure, activity or practice can be viewed as a charitable activity carried on by the activity [sic] or an inappropriate expenditure, depending on the nature of the transfer (i.e. cash, goods, services), who the recipient is and on the control exercised by the charity in the particular case at hand.
>
> Where the recipient is an employee or agent of the charity who is obliged under the terms of a contract to use the resources that are transferred in the manner stipulated by the charity, objections should not be raised.
>
> Equally acceptable are transfers of goods and services that are directed to a particular use by the very nature of the goods and services so transferred. Examples of such transfers include:
>
> > transfers, by a research organization, of books and scientific reports to anyone interested (including foreign governments, libraries, schools, etc.),
> >
> > transfers of books – on the subject of particular interest to an educational charity – public libraries and major cities all over the world,
> >
> > transfers of medical supplies to a refugee camp,
> >
> > transfers of good blankets etc. to a charity coping with a natural disaster,
> >
> > transfers of drugs, medical equipment, etc. to fully equip hospitals,
> >
> > transfers of personnel to schools or hospitals (unknown).

If a charity distributes these types of goods, it may fit under this policy, but it is noted that the CRA does not make this policy available on its website.

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A number of the CRA's requirements concerning agency agreements and joint ventures are not compelled as a matter of the law of agency or joint venture. In particular, the requirement that the Canadian charity have "direction and control" over the non-qualified donee and over the project is not compelled by the common law. That said, it appears clear from the Canadian Committee for Tel Aviv Foundation decision (see Appendix B] that the Federal Court of Appeal supports the CRA position in this regard.

It is important as a matter of prudence that an agency agreement be in writing; the CRA expresses this as a "requirement." As a matter of law, it is advisable for the registered charity to identify the scope of the relationship between agent and principal so that any claim for liability in the principal can be defended based on the scope of the agency relationship as established in the written agreement. An agency agreement also generally includes an indemnity and limitation of liability between the principal and the agent. Typically the non-qualified donee promises to indemnify the registered charity. This makes sense since it is typically the non-qualified donee that has a greater degree of control over the day-to-day operations of the charitable project.

As a matter of the general law of agency, it would be permissible for the registered charity and the non-qualified donee to enter into a general agency agreement covering activities over a number of years. However, it seems that the CRA has recently taken the position that there must be a separate agency agreement covering each individual project carried on by the non-qualified donee on behalf of the registered charity. This does not seem to be advisable as a matter of policy nor is it required as a matter of law. However, our recent experience is that the CRA, in an audit context, requires that agency agreements contemplate specific projects only.

The CRA requires agents to keep funds received from the registered charity in a separate bank account and to provide written reports from time to time on the use of the funds. This suggestion presupposes the ability of a registered charity to make advances to its agents although it is not generally advisable that advances be made.

It is possible to have a multi-tiered agency agreement where the ultimate activities of foreign charities are supervised by another non-qualified donee that is an affiliate of the registered charity. For example, it is common for Canadian charities to delegate a supervisory role in a multi-tiered agency arrangement to a U.S. sister organization. Some considerable control can be exercised by an entity that owns intellectual property licensed to another entity if this is addressed in the agency agreement or in a licensing agreement.

RC 4106 states that any property arising by virtue of the relationship between the registered charity and the non-qualified donee be owned by the charity. The CRA does, however, recognize that there may be exceptions on account of the particularities of the law of the foreign jurisdiction. For example, it is not uncommon to find that a foreign jurisdiction prohibits or restricts the ownership of real property by foreign entities. In that situation, the CRA will accept that the property purchased with funds coming from the registered charity may be owned by the foreign entity. The CRA typically requires proof of foreign law to accept such a situation. One way around this difficulty is to restrict the

registered charity's role in the foreign venture to subsidizing the operating costs of the foreign venture such that the ownership of foreign property does not arise.

Subsection 230(2) of the Act states as follows in regards to recordkeeping:

> Every registered charity and Registered Canadian Amateur Athletic Association shall keep records and books of account at an address in Canada recorded with the Minister or designated by the Minister containing (a) information in such form as will enable the Minister to determine whether there are any grounds for the revocation of it's registration under this Act; (b) a duplicate of each receipt containing prescribed information for a donation received by it; and (c) other information in such form as will enable the Minister to verify the donations to it for which a deduction or tax credit is available under this Act .

The Act requires records to be kept in Canada. This requirement can prove cumbersome. The CRA also maintains that the records must be maintained in English or in French. It might be possible, upon negotiation with the CRA, to maintain records in computer format in a way that ensures that such records are accessible from Canada. We note the Federal Court of Appeal's decision in *eBay Canada Ltd. v. Canada (National Revenue),* 2008, *FCA 348*, suggesting that documents accessible in Canada via computer are just as accessible as documents physically located in an office in Canada.

THE UNITED STATES EXPERIENCE

Grants made by U.S. charities

U.S. charitable organizations can grant to non-U.S. charities. There are rules governing such grants that are more or less onerous depending on whether the U.S. charity is a public charity or a private foundation.

Where the U.S. charity is a pubic charity, its compliance obligations for grants to "foreign" charities are not onerous. The recipient charity must use the grant for activities that are consistent with the U.S. charity's purposes.

Where the U.S. charity is a private foundation, it will be required to show that the grant is a "qualifying distribution" under *IRC 4942* and it must meet its "expenditure responsibility" obligations under *IRC 4945(h)*. These rules oblige the U.S. private foundation to obtain considerable amounts of information from the foreign charity. The foreign charity is required to enter into some form of written commitment with the U.S. private foundation to abide by various restrictions with respect to expenditures. Alternatively, there is a procedure pursuant to which the U.S. private foundation can make an "equivalency determination," that is, a determination that the foreign charity is equivalent to a US public charity. There are a variety of ways for a foreign charity to qualify for public charity status.

Fiscal sponsorship

The term "fiscal sponsorship" is commonly in use in the U.S. and is fundamentally based on *Revenue Ruling 68-489, 1968-2 CB 210* in which the IRS states: "An organization will

not jeopardize its exemption under Section 501(c)(3) of the *Code*, even though it distributes funds to nonexempt organizations, provided it retains control and discretion over the use of the funds for Section 501(c)(3) purposes." Only a few guidelines are set forth in the ruling, as follows:

> funds must be used for specific projects in furtherance of the sponsor's own exempt purposes;
>
> the sponsoring organization must retain control and discretion as to the use of the funds; and,
>
> the sponsoring organization must maintain records establishing that the funds were used for section 501(c)(3) purposes.

It appears that the U.S. legislation allows for much more scope and less restriction. This suggests that the CVO model can be accommodated.

RISKS

Complexity and Lack of Capacity

There is no question that operating a charitable venture organization is administratively complex and requires a sophisticated understanding of the regulatory regime, the disbursement quota rules, the differences among the possible forms of collaboration, and the manner in which each is required to be administered. Without a comprehensive framework and considerable administrative and financial capacity in the organization, as well as controls, which ensure each semi-autonomous project understands its obligations, such an organization is likely to be unwieldy and ungovernable with a substantial risk of non-compliance with the regulatory regime. If poorly managed, such an organization neither increases the efficiency of the charitable sector nor advances its cause.

Many foundations, granting bodies, and funders have long-standing policies that permit only a single annual grant to an organization. Such a policy does not fit particularly well with the CVO model, which may house multiple and diverse projects, a number of which may otherwise meet the granting criteria of a community foundation. Notwithstanding that its projects and capability are very attractive to funders, TCI has found this restriction to be a challenge in some circumstances and has been working successfully with funders to address this.

Compliance

The current state of the Act and the manner of its administration by the CRA makes compliance tricky without a sophisticated understanding of the regime and an application of that understanding to the administration of the organization. The risks of being found non-compliant by the CRA are challenging because they go to the heart of the organization's ability to operate and to fundraise. The reputational risk of running afoul of the CRA could permanently damage the credibility of a charitable venture organization.

RECOMMENDATIONS

We make the following recommendations:

Recommendation One

An appropriate name for this model is a "charitable venture organization" [CVO].

Recommendation Two

The development of a best practices framework for charitable venture organizations is desirable. Such a framework would include the administrative best practices that all charitable organizations should follow as a matter of course, such as the preparation of an annual budget which is approved by the board of directors and internal financial controls, as well as:

- written applications required for ventures/projects seeking a "home" within a charitable venture organization;

- guidelines for the evaluation of and assumption by the charitable venture organization of financial and legal responsibility for ventures/projects, which would include consideration of the "mission fit" of the venture/project within the charitable venture organization and an evaluation of the potential venture/project leadership;

- terms of reference for every venture/project, which would include provisions for fundraising obligations, if any; the termination of the venture/project and the disposition of its assets/liabilities; any communication responsibilities to funders or otherwise; and dispute resolution;

- the requirement for a Project Committee for each venture/project to oversee the venture/project and ultimately report to senior management;

- guidelines for the review of all contracts and other legally binding documentation relating to ventures/projects and execution only by authorized signatories of the charitable venture organization;

- systems that assess venture/project risk and manage it;

- systems that ensure that venture/project specific funds are used only for the permitted purpose and that track compliance with the terms of grant or contribution agreements;

- systems for establishing a budget and monitoring expenditures of ventures/projects;

- fund accounting for ventures/projects;

- an easily understood methodology for cost allocation to ventures/projects;

- systems that allow for reporting (both financial and activity based) for ventures/projects;

- policies regarding the allocation of staff to ventures/projects and the training of staff.

Recommendation Three

Rigour needs to be brought to the development of the charitable venture model. At present, it is possible, given sufficient knowledge and capacity, for an organization to operate the model in compliance with the Act. The model can enhance compliance and efficiency and reduce the cost and administrative infrastructure required to conduct charitable programs – this is of considerable interest to the funding partners of the voluntary sector. A comprehensive charitable venture model will be "scalable."

The voluntary sector, including its funding partners, must collaboratively develop a common language to be used for this model and decide on applicable benchmarks.

CONCLUSION

We seek input from the public and voluntary sector on our recommendations. General comments on the model are also welcome. Comments should be directed to: Vivian Yeung at vivian.yeung@tidescanada.org

Note

1. This report was prepared prior to the Federal Budget of March, 2010.

APPENDIX A

TIDES CANADA INITIATIVES SOCIETY: CHARITABLE VENTURE ORGANIZATIONS: A NEW INFRASTRUCTURE MODEL FOR CANADIAN REGISTERED CHARITIES

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SECTOR REPRESENTATIVES AND LEGAL PRACTITIONERS
continued

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APPENDIX B

CASE LAW

There are three court decisions of interest in this area.

- *The Canadian Committee for the Tel Aviv Foundation v. The Queen, 2002 FCA 72 (March 1, 2002)*

The Canadian Committee for the Tel Aviv Foundation (the "Committee") became a charitable organization in 1985. It was founded to promote education and relieve poverty and sickness in Tel Aviv, Israel. It pursued these activities through the Tel Aviv Foundation, an Israeli charity, which acted as its agent in Israel under a written agency contract.

The Minister of National Revenue (the "Minister") audited the Committee's 1990 and 1993 taxation years. A third audit for the 1997 taxation year led to the Minister's revocation of the Committee's charitable status. In the 1997 audit, as with the previous two audits, the Minister described numerous improper procedures in the Committee's dealings with its agent, including failing to exercise control over its own funds, failing to demonstrate adherence to a system of continuous and comprehensive reporting, and failing to abide by the agency agreement signed by the Committee and its representative in Israel. The Committee had undertaken with the Minister, as a result of the second audit, to address these improprieties. The Minister revoked the registration as a result of the third audit because the improprieties had not been corrected.

The Committee appealed the Minister's decision to revoke its charitable status to the Federal Court of Appeal. The Federal Court of Appeal rejected the Committee's arguments.

The Court determined that the Minister's principal reason for revoking the registration was the loss of control by the Committee over its funds. The evidence collected by the Minister in the 1993 and 1997 audits indicated that the agent, Tel Aviv Foundation, received monies from the Committee and mixed those monies in with its own funds. The Court found that the Tel Aviv Foundation had complete discretion over the use of the monies received from the Committee. The Committee was unable to present documentary evidence to gainsay the Minister's position with respect to the use of funds. The Court also found that the audits presented the Minister with sufficient reasons to revoke the Committee's registration.

The following passage states the Court's view of the necessity for control by the Canadian charity of the activities of its foreign agent:

> [30] In my analysis, the Committee misconstrues the Minister's position. Under the scheme of the Act, it is open to a charity to conduct its overseas activities either using its own personnel or through an agent. **However, it cannot merely be a conduit to funnel donations overseas. In this case, the Agency Agreement was ignored by the Committee, and the Minister was not satisfied that the Committee's explanations of its conduct overseas were sufficient to overcome his conclusion that the Committee had no direction or control over how funds were spent by its agent.** The evidence that was provided would suggest that the Committee was merely acting as a conduit for Canadian donors to overseas donees. For example, the evidence discloses that the Committee sent the majority of the funds it raised to its agent in Israel, but provided little documentary evidence of the Committee's control over how those funds were spent. The Committee submits that the written Agency Agreement was superseded by subsequent oral arrangements with its agent, and asserts that its directors had travelled to Israel on numerous occasions specifically to oversee and direct the agent's activities pursuant to those oral arrangements. **Again, however, there is little evidence on the record from which this Court might conclude that the Committee was, in fact, exercising the control and direction it claims.**
>
> [31] In my view, in light of this conflict between the Agency Agreement and alleged oral arrangements, and considering the many other concerns raised by the Minister, such as the improper recording of expenditures in the Committee's records, the agent's failure to keep a separate bank account, and the lack of documentary evidence of direction and control by the Committee, **it was not unreasonable for the Minister to conclude that the Committee was not in control or direction of its agent in Israel. His conclusion is all the more reasonable in light of the Committee's failure to comply with its 1996 Undertaking, whereby it undertook to abide by the terms of the written Agency Agreement.** [emphasis added]

- *Canadian Magen David Adom For Israel /Magen David Adom Canadien Pour Israel v MNR 2002 FCA 323*

Canadian Magen David Adom For Israel ("Magen David Adom") became a charitable organization in 1976. Its primary purpose was to donate emergency medical supplies and ambulances to the people of Israel.

The organization was audited a number of times subsequent to its registration (1983, 1984, 1987, 1988, 1993, and 1996). In each case the Minister took exception or raised concerns regarding the activities of Magen David Adom in Israel. In the 1983 and 1984 audits, the Minister's complaint was that ambulances and medical supplies were being purchased for shipment to Israel by the American affiliate of Magen David Adom and that the funds collected by Magen David Adom for the construction of a blood analysis centre were transferred to the Israeli affiliate of Magen David Adom. That audit was resolved, largely, with the Minister accepting that the provision of ambulances was with-

in the Minister's recently developed (December 11, 1985) policy concerning "charitable goods." Pursuant to that policy

> [19] gifts – and other transfers and other services – are often made by registered charities to non-qualified donees in complete compliance with the Act… These are transfers made in furtherance of charitable purposes and more importantly, the expenditures are, themselves, evidence of charitable activities.

This "charitable goods" policy seems to have been developed in response to the audit issues raised in the *Magen David Adom* matter.

The audits for the years 1987 and 1988 did not result in any substantive correspondence or undertaking.

There was correspondence between the Minister and the charity in October 1993, which followed on the request of Magen David Adom for the Minister's permission to help its Israeli affiliate to purchase an identification system and a telecommunication system for ambulances. In response to that request the Minister informed the charity that

> [26] 'a registered charity may not simply act as a conduit to channel funds to those organizations to which a Canadian taxpayers could not directly make a gift and requires some tax relief… A registered Canadian charity is expected to maintain the same degree of the administrative control over the use of its resources outside Canada as it would if it's activities were conducted in Canada'.

The letter concluded with a detailed list of the elements of an agency agreement. The Minister, in a letter of March 23, 1994, indicated its acceptance of a transfer of funds from Magen David Adom to the Israeli entity on the basis that the funds were to cover an expense incurred for the telecommunications system for ambulances and that such an expenditure was directly fulfilling Magen David Adom's purposes. The Minister's letter stated:

> [28] 'a charity may transfer certain goods or provide services to another organization in order that those goods and services can be used in the recipient charitable programs if the goods and services provided can, by their very nature, be used only for charitable purpose'.

There was an audit in 1993 in which the Minister again approved donations of medical supplies and ambulances by Magen David Adom to its Israeli affiliate. The Minister again raised the issue of the failure of Magen David Adom to enter into an agency agreement with its Israeli affiliate.

The same issue was raised in the 1996 audit. The Minister issued an administrative fairness letter on December 14, 1998, indicating its intention to revoke Magen David Adom's charitable registration.

Following various meetings between the Minister and Magen David Adom, the Minister issued a Notice of Revocation on July 10, 2001. It gave the following three grounds for revocation:

- certain alleged and improper receipting practices;
- carrying on activities that were said to be in contravention of Canadian public policy concerning activities conducted in the Occupied Territories in Israel; and
- gifting resources to the Israeli affiliate.

The Federal Court of Appeal ignored the first ground. With respect to the second, the Federal Court of Appeal found that the reported public policy did not exist. With respect to the third ground – gifting its resources to non-qualified donees – the Court found in favour of the Minister. The Court stated:

> [66] As explained earlier, a charitable organization is obliged to carry on its charitable activities itself. If it does not do so its registration may be revoked. **A charitable organization that wishes to operate in a location where it has no officers or employees must somehow act through a person in that location. That obviously could be done by establishing an agency relationship between the charity and that person. Evidence that such a relationship has been established by contract, and if that the contract has been adhered to, might well be the most straightforward means of proving to the Minister that a person purporting to carry out the charitable activities of a charity in a particular location is in fact acting on behalf of the charity. It is possible that the same result might be achieved by other means. However, a charity that chooses to carry out its activities in a foreign country through an agent or otherwise must be in a position to establish that any acts that purport to be those of the charity are effectively authorized, controlled and monitored by the charity.** [emphasis added]

The decision raised but did not answer the question whether the charitable goods policy was valid in the sense of being well founded in law.

- *Bayit Lepletot v. MNR*, 2006 D.T.C. 6321 [2006] 3 C.T.C. 252 (F.C.A.)

In the *Bayit Lepletot* decision, the Federal Court of Appeal upheld the Minister's decision to revoke the registration of the Canadian charity on the basis that it did not provide sufficient evidence that the individual in Israel in receipt of funds from the Canadian charity was actually acting as its agent in disbursing such funds. That individual was a rabbi who had supervision of a number of orphanages operated by an Israeli organization. The rabbi in question was part of the administration of the Israeli organization. The Court held that the charity failed to show that the rabbi was carrying on the Canadian charity's charitable works as opposed to those of the Israeli organization.