Establishing a Parallel Foundation: Why? Why Not? How?*

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Introduction

In these times of donor fatigue and government cutbacks, a growing number of charitable organizations are considering whether or not to establish a foundation. While so-called "parallel foundations" are becoming more popular,[1] not every organization can benefit from them. This article will identify the main reasons for establishing a foundation, the advantages of a foundation, and which charities are most likely to benefit from setting one up. Control issues between the charity and foundation, as well as certain key provisions of the *Income Tax Act* relating to public foundations, will also be discussed.

For the purpose of the following discussion, a "parallel foundation" means a public foundation that is established by the board of a "parent" charitable organization. Both are registered charities under the *Income Tax Act*.[2] A distinction should also be made between a charitable organization and a foundation. A charitable organization carries on charitable activities itself while a foundation is primarily a funding body. Foundations raise money (either by accumulating capital or through campaigns) and transfer funds to other registered charities which carry out charitable purposes; however, parallel foundations can also carry on charitable activities directly. In fact, they have more flexibility in this regard than charitable organizations since public foundations can disburse to qualified donees without limitation. Charitable organizations, in contrast, are restricted to disbursing no more than 50 per cent of annual income to non-associated charities.

The definition of a charitable foundation can be found in subsection 149.1(1)(a) of the *Income Tax Act*:

> ...'charitable foundation' means a corporation or trust constituted and operated exclusively for charitable purposes, no part of the income which is payable to, or is

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otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof and that is not a charitable organization;

According to this definition then, a parallel foundation must be in the form of a corporation or trust. This is to be distinguished from a charitable organization which can take any form, including that of a voluntary association. Under the definition of "registered charity" in subsection 249(1) of the *Income Tax Act*, the corporation or trust must be resident in Canada and must be created or established in Canada. In practical terms this means that a majority of the board of directors or trustees of a parallel foundation must be resident in Canada.

In order to qualify as a public foundation (as opposed to a private foundation), two conditions must be satisfied:

1) More than 50 per cent of the directors, trustees, officers or officials must deal with each other at arm's length; and

2) Not more than 50 per cent of the contributed capital can come from one person or group of persons not dealing at arm's length.

In computing the sources of contributions for the purposes of the second test, gifts from Her Majesty, a municipality, another registered charity (other than a private foundation) or a nonprofit organization will not be counted. If only one of these tests is satisfied, presumably the foundation will be classified as a private foundation by Revenue Canada.

Why Set Up A Parallel Foundation?

There are various reasons why charitable organizations set up foundations but they are usually related to the creation of an endowment or the segregation of funds.

Creating an Endowment

The creation of a capital base or endowment for the ultimate benefit of a "parent" charitable organization is perhaps the most common reason to set up a parallel foundation. By gradually building up a large capital base, the foundation can produce a flow of income to the charity in the future. The benefits of such an approach are self-evident, particularly in these difficult economic times.

Take the example of a charity that is dedicated to the support and maintenance of education and development in the developing world. It received 80 per cent of its funding from government and its remaining funding from sponsorship and cash gifts. In 1992, the charity's government funding was cut by close to 15 per cent. Although the charity scrambled to increase its fund-raising revenue to compensate, it suffered a serious shortfall in 1992. In 1993, it suffered a further 10-per-cent cut in government funding. It soon became evident that

without a serious marketing effort and a concerted and imaginative fund-raising plan, the charity might not survive. In the course of developing a strategic plan to meet its new situation, the charity examined the characteristics of its donor base and found that about 60 per cent of its regular donors were over the age of 65.

There are a few observations that should be made about this example. If the charity had established a viable foundation several years ago so that it had already built up a sizable endowment, the impact of the reduction in funding would not have been nearly as significant. Further, the charity's largest donor base is over 65 years of age, the very group that is most interested in "planned giving", the type of fund-raising vehicle most commonly used by foundations. This group of regular donors would probably have made contributions to such a foundation over the years. Unfortunately, in real life, the charity in question only established a foundation in 1992 and although great strides have been made in attracting planned gifts, it is years away from being able to provide a secure flow of income to the charity. Clearly if it can survive in the short term, the foundation will prove to be invaluable in the future.

The desire to create an endowment naturally involves consideration of the type of fund raising required to attain this goal because fund raising carried on by a foundation can be quite different from that of a charitable organization. Charitable organizations rely extensively on cash gifts made on an annual basis by individuals and businesses. Foundations, in contrast, are concerned with long-term fund raising and typically rely on "planned giving".

Not long ago, planned giving was almost a foreign concept to Canadian charities; however, over the last decade or so, more and more organizations and donors are becoming knowledgeable about what it entails and the benefits that can be derived. Generally, planned giving involves the use of bequests, insurance programs, charitable remainder trusts and, sometimes, charitable gift annuities which provide significant long-term increases of capital when their donors die.

It would appear that most charities with plans to operate indefinitely could benefit from building up a secure capital base through the use of a foundation but it is not that simple. Most charities which are in the position to build up an endowment have been around for a while and are in a relatively secure position vis à vis their current operating costs. In other words, they are able to spend the necessary time and money required to establish an effective foundation. However, building up an endowment is no easy task and often involves a sophisticated level of fund raising that many charitable organizations do not possess. Most charitable organizations rely on volunteers for a significant part of their fund raising and it is unlikely that a committee of volunteers will have the time or expertise necessary to devote to building up an endowment in a separate

parallel foundation. Unless the foundation is enormously blessed with skilled volunteers with ample free time, it is doubtful that it could successfully implement a capital campaign without professional assistance or help from paid staff.

Thus, it is not uncommon for a charity with the best of intentions to establish a parallel foundation and then effectively "abandon" it. Unless the charity has the expert resources necessary to build up capital, the best advice is not to establish a foundation in the first place because the charity will be too busy raising money needed to cover its current operating costs. The exception arises when the charity has received a substantial donation that can be used as seed money to fund the foundation.

Segregation of Funds

The reasons for segregating funds and transferring them to a parallel foundation include:

- a desire to distinguish between annual and capital fund raising;
- a perceived need to protect surplus funds from future boards;
- a wish to perpetuate the names of particular donors; and
- the desire to transfer "excess funds" to a foundation so as not to affect future government funding decisions.

It will be useful to consider each of these reasons in turn.

The need to distinguish between annual and capital fund-raising campaigns is important. Most charitable organizations busy themselves each year with an annual fund-raising campaign to raise money to cover operating needs. A foundation, on the other hand, uses a capital campaign to build up an endowment. While there is nothing to stop a charitable organization from running a capital campaign, the concern is that the first time it is in a cash crunch, it will use capital funds to meet immediate needs; however, if a foundation has been created, capital funds cannot automatically be drawn from it for this purpose.

Usually foundation fund raising is carried out on a year-round basis and involves different people from those involved in the charity's annual campaign. This allows two campaigns to be run at the same time for different purposes. Experience would seem to suggest that the establishment of a foundation, including the institution of a planned giving campaign, does not diminish the annual donations made by donors to the parent organization. In fact, the donor list compiled by the charitable organization for the annual campaign is a useful tool for the foundation when it embarks on a planned giving campaign. Since planned giving is an entirely different type of charitable giving, it expands the donor's options for supporting the organization.

A word of caution: there is a donor education issue that should be taken into account. When a parallel foundation is created, it is possible that regular donors may become confused as to how to direct their gifts. A careful education campaign is necessary in order to direct major gifts to the foundation while at the same time maintaining regular annual donations to the charitable organization.

The second reason, a desire to protect surplus funds from future board members, can apply when an incumbent board has been successful in building up capital contributions within a charitable organization and wants to ensure that the funds are protected for use by the charity in the future. The concern here is that a future board may not be sufficiently concerned about planning for the charity's future and that, in the event of a cash shortfall, it will "encroach" on capital, rather than doing additional fund raising or meeting the need in some other way.

Transferring capital contributions to a foundation can usually accomplish this purpose. The need to perpetuate donors' names can arise when, for example, a donor has made a major contribution to a hospital for the establishment of a fund for research into a particular disease. The establishment of a named fund is much easier within a foundation than within a charity which is primarily concerned with operating funds. In addition, organizations fortunate enough to build up "excess funds" are sometimes concerned about holding a large capital fund when they are soliciting operating funds from another charity or from government. Traditionally, for example, many hospital foundations were established so that hospitals could transfer funds to the foundation in an attempt to avoid the possibility of a government cutback based on the appearance of large capital funds in the charity's financial statements.

Summary: Who Should (Should Not) Consider Setting up a Parallel Foundation?

Most major charitable organizations that are easily meeting current operating expenditures can benefit from setting up a parallel foundation. Indeed, the establishment of a foundation can be likened to contributing to an RRSP. It may be painful in the short term but the financial security afforded in the future makes it highly desirable. Assuming some degree of financial security in meeting current obligations, organizations in the following circumstances should consider establishing a parallel foundation:

- an organization that has already received significant bequests or other planned gifts so could use the capital received as seed money to endow a foundation (provided that these funds are not already impressed with a trust inconsistent with that purpose.);

- an organization that is already involved in a successful planned giving campaign should consider moving the whole program into a foundation so as not to divert interest from the operating needs of the charity;
- an organization that relies heavily on government funding should consider establishing a foundation to provide future protection in the (likely) event of government cutbacks;
- an organization which has a need to protect capital funds from future boards.

On the other hand, organizations with a relatively small operating budget that carry on activities on a relatively small scale will be unlikely to have a need for a parallel foundation. Similarly, those that need all of their resources for current objectives will not have the time or funding necessary to set up an effective foundation. Finally, charities that have a secure source of funding both for present and future operating needs may not need to be as concerned with the longer term.

Income Tax Act

There are two principal *Income Tax Act* requirements that must be met by a parallel foundation. First, the foundation must conform to the *Act's* disbursement quota rules. There is little difference between the disbursement quota of a charitable organization and a public foundation except that a foundation must take capital into account in calculating its quota. The requirement to disburse can be fulfilled by a parallel foundation in two ways: by carrying on charitable activities and by making gifts to qualified donees.

However, the calculation of a foundation's disbursement quota is somewhat more complex than that of a charitable organizations and normally a foundation will need the services of an accountant to assist it in the practical application of the disbursement quota. The definition of the disbursement quota in section 149.1(1) of the *Income Tax Act* applies to foundations, with certain subsections applying only to public or private foundations. In general, the disbursement quota of a public foundation involves a calculation of the following amounts:

- 80 per cent of receipted donations received in the immediately preceding year excluding gifts received by way of bequest or inheritance, 10-year "retained" gifts and gifts from registered charities; and
- 80 per cent of the amount of gifts received from a registered charity in the immediately preceding year other than a specified gift (a gift of capital which is not deductible by the donating charity in computing its own disbursement quota); and

- 4.5 per cent of property owned by the foundation and not used directly in charitable activities or administration, other than prescribed property.

Certain sources of income are exempt from consideration for the purposes of computing the disbursement quota: specified gifts from other charities, 10-year gifts, bequests, and non-receipted gifts. However, to the extent that any of these gifts is retained, starting with the year after receipt, they are included as part of the foundation's assets and are subject to inclusion for the purposes of the 4.5-per-cent rule regarding property owned by the foundation and not used directly in charitable activities or administration.

It should be noted that where a charitable organization funds a parallel foundation it must do so by means of a *specified* gift and not through a gift subject to the 10-year rule. This is because if a gift is received from a registered charity and is subject to the 10-year rule it will be subject to calculation as part of the disbursement quota because the gift is not specified. Technically the foundation would have to disburse the full amount of the gift in the year following its receipt even though to do so would breach the terms of the trust under which the gift was received.

The second aspect of the *Income Tax Act* which concerns a parallel foundation is that the *Act* (s.149.1(3)) sets out circumstances under which the Minister can deregister a public foundation. In contemplating whether to set up a parallel foundation, it is important to be aware of these. A foundation could be deregistered if it failed to meet its disbursement requirements or carried on a business other than a related business. It could also be deregistered if it acquired control of a corporation,[3] although this rule does not apply if the foundation acquired the shares through a gift or a bequest. Finally, a foundation could be deregistered if it incurred debts other than debts for current operating expenses, debts in connection with the purchase and sale of investments and debts incurred in the course of administering charitable activities.

Establishing a Parallel Foundation

Preliminary Considerations

Once an organization has decided to establish a parallel foundation there are issues which must be considered at the outset, including:

- who should be the beneficiary or beneficiaries of the foundation;
- whether the foundation should be in the form of a nonshare capital corporation or a trust; and
- how the foundation should be controlled.

Consideration should be given to whether the foundation should start from scratch in its fund raising or whether the organization should transfer its own capital (or part of it) to the foundation to get it started.

Who should be the beneficiary of the foundation is obviously a matter for the charitable organization to decide for its own reasons. However, this is not necessarily a simple matter when it comes to drafting the foundation's objects.

The typical objects of a parallel foundation are to raise funds and to transfer all or a part of the funds or the income therefrom to the "parent" charitable organization. Limiting the objects in this way ties the hands of the foundation directors (which may be a desirable thing) and tends to make them little more than figureheads. If this is what is wanted, the objects will read something like this:

> To receive or maintain a fund or funds and to transfer from time to time all or part thereof or the income therefrom to Charity X.

Even if this narrow approach is desired it is usually wise to consider the possibility that Charity X may cease to exist and so the following is recommended at the end of the above objects:

> ...or if Charity X ceases to exist, then to another charity registered under the *Income Tax Act (Canada)* which in the opinion of the board of directors of the foundation carries on similar activities to Charity X.

A charitable organization may, however, prefer a broader approach. It may wish to establish a foundation that is completely under its control but with objects that contemplate the possibility of a disbursement to another charity. The foundation's directors would have the power to distribute funds to any charity they selected. In such a case the objects would be stated as:

> To receive or maintain a fund or funds and to transfer from time to time all or part thereof or the income therefrom to Charity X or to other charities registered under the *Income Tax Act (Canada)* having similar objects or to other qualified donees as defined from time to time under the *Income Tax Act (Canada)*.

It is also important to decide who should be the beneficiary if the foundation is ever dissolved. The dissolution clause of a parallel foundation invariably provides that any remaining assets will be transferred to the parent charitable organization on dissolution and would read:

> It is specifically provided that in the event of dissolution or winding up of the corporation all its remaining assets after payment of its liabilities shall be distributed to Charity X or, if Charity X ceases to exist, to one or more charitable organizations

registered under the *Income Tax Act* which in the opinion of the board of directors of the corporation carry on similar activities to Charity X.

The next consideration is whether the foundation should take the form of a nonshare capital corporation or that of a trust. Many people feel more comfortable using the corporate form because of its familiarity. Others prefer to use it because many of the rules relating to internal governance are set forth in the governing legislation. The trust, however, is every bit as good as a corporation and may, indeed, be preferable. A trust requires no "corporate" filings or returns and in some respects offers greater flexibility than the corporate form. For example, a trust can establish its own rules of governance; there are no legislative requirements governing the minimum number of trustees; and there is no requirement for members so no requirement for annual meetings.

The next consideration is that of who should control the foundation. Some charitable organizations put control of the foundation into the hands of the organization's board. Others use "outsiders" or a combination of outsiders and organization board members. There is no right answer to this question; it depends on the reason for setting up the parallel foundation and the desired level of interplay between the organization and the foundation. This subject will be discussed in more detail below.

Choosing the Jurisdiction of Incorporation

Assuming that incorporation is the chosen method of establishment, an issue arises as to the jurisdiction in which incorporation should take place.

A foundation may be incorporated under either the *Canada Corporations Act*[4] or provincial legislation. (In this paper I use Ontario's *Corporations Act* as an example.) Usually, if a charitable organization is incorporated in one jurisdiction and wishes to establish a parallel foundation it will do so in the same jurisdiction. This is not, however, a legal requirement and charities incorporated in Ontario, and those in other provinces, are increasingly incorporating foundations at the federal level to avoid the delays and frustrations that are sometimes associated with provincial incorporation, at least in Ontario. As will be discussed below, incorporation at the federal level or the establishment of a trust avoids the need for approval by the provincial Office of the Public Trustee.

To incorporate under the *Canada Corporations Act*, the corporation's objects must fit within the requirements of section 154(1) which states:

> The Minister may by letters patent under his seal of office grant a charter to any number of persons, not being fewer than three, who apply therefor, constituting the applicants and any other persons who thereafter become members of the corporation thereby created, a body corporate and politic, without share capital, for the purpose

> of carrying on, without pecuniary gain to its members, objects, to which the legislative authority of the Parliament of Canada extends, of a national, patriotic, religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character, or the like objects.

The objects should generally be of national concern or the corporation must intend to carry on activities beyond the boundaries of one province. The primary objects of a parallel foundation as discussed above empower the foundation to raise funds anywhere in the country and are usually accepted for incorporation at the federal level.

An application for incorporation, together with the required statutory declaration and bylaws, must be submitted for review to the federal Corporations Directorate at the Department of Industry Science and Technology, together with the prescribed fee of $200. Since the Department will conduct a name search (for a small fee) it is not necessary to include a NUANS name search report when applying to incorporate at the federal level. The requirement to prepare bylaws prior to incorporation may seem onerous but it is important since it forces incorporators to address critical issues dealing with how the parallel foundation will be managed. The bylaws are absolutely critical for establishing the necessary control mechanisms between the organization and the foundation and must be drafted with precision.

Since the *Canada Corporations Act* provides very little guidance regarding what is permitted in bylaws of nonshare corporations, the Department has produced a very useful information package which sets forth the Department's unlegislated requirements for those matters which must be included in bylaws.[6] The Corporations Directorate is very efficient and helpful in its review process and usually processes an application for incorporation in two to four weeks.

Any person may incorporate a nonshare corporation under Ontario's *Corporation Act* provided that the corporation "has objects that are of a patriotic, religious, philanthropic, charitable, educational, agricultural, scientific, artistic, social, professional, fraternal, sporting or athletic nature or that are of any other useful nature".

Incorporating a charity under this *Act* requires that the application for incorporation first be provided to the Public Trustee's Office for review along with a statement describing how the foundation will operate and its anticipated funding arrangements. The Public Trustee's approval must be received before the application will be processed by the Ministry of Consumer and Commercial Relations. The fee charged for this review is $120 and it is important to include these special provisions required by the Public Trustee:

1. The corporation shall be carried on without the purpose of gain for its members and any profits or other accretions to the corporation shall be used in promoting its objects.

2. The corporation shall be subject to the *Charities Accounting Act* and the *Charitable Gifts Act.*

3. The directors shall serve as such without remuneration and no director shall directly or indirectly receive any profit from his/her position as such provided only that directors may be paid reasonable expenses incurred by them in the performance of their duties.

4. The borrowing power of the corporation pursuant to any bylaw passed and confirmed in accordance with section 59 of the *Corporations Act* shall be limited to borrowing money for current operating expenses, provided that the borrowing power of the corporation shall not be so limited if it borrows on the security of real or personal property.

5. Upon the dissolution of the corporation and after payment of all debts and liabilities, its remaining property shall be distributed or disposed of to charitable organizations which carry on their work solely in Ontario (or, alternatively, in Canada).

6. If it is made to appear to the satisfaction of the Minister, upon report of the Public Trustee, that the corporation has failed to comply with any of the provisions of the *Charities Accounting Act* or the *Charitable Gifts Act*, the Minister may authorize an inquiry for the purpose of determining whether or not there is sufficient cause for the Lieutenant Governor to make an order under subsection 317(1) of the *Corporations Act* to cancel the Letters Patent of the corporation and declare it to be dissolved.

When preparing an application for incorporation, reference should be made to the *Not-For-Profit Incorporators Handbook* which is a very useful guide to incorporating in Ontario.[7] Once the Public Trustee's consent has been obtained, the application for incorporation should be filed in duplicate, together with the NUANS name search report and the prescribed fee of $155, with the Companies Branch of the Ministry of Consumer and Commercial Relations.

As noted above, incorporated foundations in Ontario are subject to the supervisory jurisdiction of the Public Trustee through the *Charities Accounting Act*[8] and the *Charitable Gifts Act.*[9] In describing which corporations are brought within the *Charities Accounting Act*, section 1(2) provides:

> Any corporation incorporated for a religious, educational, charitable or public purpose shall be deemed to be a trustee within the meaning of the *Act*, its instrument of incorporation shall be deemed to be an instrument in writing within the meaning of

this *Act* and any real or personal property acquired by it shall be deemed to be property within the meaning of this *Act*.

Similarly, the *Charitable Gifts Act* applies to every person (which includes a corporation) of a religious, charitable, educational or public character.

It is generally accepted that both the *Charities Accounting Act* and the *Charitable Gifts Act* apply to charities incorporated in Ontario. In fact, because of its supervisory role, all applications for Letters Patent, Supplementary Letters Patent, amalgamation, continuations, surrenders of charter and dissolution of charities in Ontario must be submitted to the Office of the Public Trustee before being filed with the Companies Branch of the Ministry of Consumer and Commercial Relations. It is interesting to note that there does not appear to be any statutory authority for this approval procedure but it appears to be the Public Trustee's primary method of monitoring the activities of charities and other nonprofit organizations. If the corporation has not met its filing requirements, the Public Trustee may require audited financial statements and other information dating back to incorporation.

The Public Trustee also asserts jurisdiction over extra-provincial corporations and organizations incorporated under the laws of Canada that are operating in Ontario. The Office of the Public Trustee takes the position that this can be constitutionally justified as being a proper exercise of the Province's jurisdiction over "charities" under Section 92(7) of the *Constitution Act*, 1982. The Province's right to regulate the activities of charities operating within the province is undisputed. However, apart from possible notification or registration requirements, the question of whether a province can regulate other matters coming under the *Charitable Gifts Act* and *Charities Accounting Act*, such as the holding of property or business interests by an extra-provincial or federal corporation or other corporate governance matters such as the remuneration of directors, is not as clear.

The *Charities Accounting Act* makes a corporation to which the *Act* applies a trustee of its property for the purposes of the application of that *Act*. Section 1(1) of the *Act* requires that notice in writing be given to the Office of the Public Trustee following incorporation. However, since the Public Trustee approves Applications for Incorporation in Ontario, it is possible that such notice is not necessary for a corporation that is incorporated under Ontario's *Corporations Act*.

Complicating matters in Ontario is the fact that the Office of the Public Trustee has stated that it will not recognize as charitable a foundation set up to raise funds for charitable purposes. This may seem quite alarming at first and, indeed, may be a real barrier to many charities hoping to establish a foundation in Ontario. The Public Trustee's Office bases its position on the undoubtedly

correct legal proposition that fund raising is not *per se* a charitable activity. As a result, the Public Trustee's Office will not approve for incorporation any organization that has been set up "primarily" to raise funds for charitable purposes.

However, there is an exception to this rule. If the foundation is already endowed or will be endowed soon after creation, it will probably be approved by the Public Trustee's Office. For example, if a hospital or other charity agrees to transfer capital to the foundation after incorporation the foundation will be approved. The rationale for this exception is difficult to follow but presumably the Public Trustee bases its reasoning on the assumption that a foundation that is already endowed will not be fund raising on the same scale as one that is not.

It appears then, that a charity that wishes to establish a separate foundation in Ontario but that is not in a position to transfer substantial capital to it may be refused by the Office of the Public Trustee. One way around this potential problem is to incorporate the foundation under the *Canada Corporations Act* or establish the foundation by way of trust, thus avoiding the approval process with the Office of the Public Trustee. However, even though the Public Trustee's office would not be involved in approving the application for incorporation at the federal level, the Public Trustee still asserts jurisdiction over all charities carrying on activities in Ontario, regardless of where they are incorporated or established.

The Public Trustee's Office review process usually takes between three and five weeks to complete. After the application for incorporation has been approved it must then be provided to the Companies Branch of the Ministry of Consumer and Commercial Relations for processing and this process can literally take months to complete. In Ontario, there is no requirement to submit bylaws to the Ministry for review.

It should be noted that sections 8 through 10 of the *Charities Accounting Act* prohibit charities and other nonprofits to which the *Act* applies from holding land unless it is held for the "actual use or occupation of the land for the charitable purpose". In addition the *Charitable Gifts Act* prohibits corporations to which the *Act* applies from owning more than 10 per cent of the shares of any business.

Reporting Obligations After Incorporation

In addition to the requirement to file information returns under the *Income Tax Act* (and possibly with the Ministry of Revenue for the Province of Quebec if registered as a charity in that province), most provincial and federal legislation requires nonshare capital corporations to comply with certain other "corporate" reporting requirements on a regular basis. Failure to comply with these requirements can expose the corporation to penalties under the applicable legislation.

Section 133(2) of the *Canada Corporations Act* provides that once incorporated, a corporation must file an Annual Summary with the Corporations Directorate of the Department of Industry, Science and Technology, on or before June 1 of every year. The Annual Summary must be filed in duplicate and contain certain prescribed information about the corporation as of the preceding March 31st. Annual Summary forms are usually mailed to each corporation at its postal address on record with the Department around March 31 of each year.

Federally incorporated nonshare corporations are not required to file a notice of change or any other document if there is a change in directors since this information must be included on the Annual Return. If the address of the head office of a federal nonshare corporation changes to another municipality, a bylaw is required to make this change and notice of the bylaw must be published in the *Canada Gazette*. If the head office is changed to another location from the one specified in the letters patent or bylaws but within the same municipality, there is no obligation to report. It should be noted that federally incorporated nonshare corporations that will be operating in Ontario are required to file an Initial Notice with the Companies Branch of the Ministry of Consumer and Commercial Relations within 60 days of commencing operation in Ontario. From time to time Special Notices must also be completed and filed.

Ontario nonshare corporations are subject to a number of filing and publication requirements. Instead of filing an annual return, in Ontario, the *Corporations Information Act*[10] requires every corporation to file an Initial Notice setting out certain prescribed information (including the names of directors and officers) as of the date of filing, within 60 days of incorporation. Thereafter, the corporation must file a Notice of Change each time the information changes in the Initial Notice or a previous Notice of Change. The Notice of Change must be filed within 15 days of the change taking place. Apparently an annual reporting system similar to that operating under the federal jurisdiction will eventually be mandatory in Ontario.

A corporation under the *Corporations Act* of Ontario is also subject to certain mandatory filing and publication requirements in the event that the number of directors on the board increases or decreases and in the event of a change in the head office address of the corporation. In both cases, notice of the special resolution authorizing the change must be filed with the Companies Branch and published in the *Ontario Gazette* within 14 days after the resolution has been confirmed by the members.

The *Not-for-Profit Incorporator's Handbook* sets out corporations' reporting obligations to the Ontario Public Trustee. Essentially, every such corporation (which presumably would include extra-provincial corporations and federal

corporations under the *Canada Corporations Act*) is required to make regular filings with the Office of the Public Trustee, including:

- Copies of all documents (such as Supplementary Letters Patent) making any change to the document establishing or governing the charity;
- The street and mailing address of the corporation, if different from the last filing;
- The addresses of the directors and officers of the corporation, if different from the last filing; and
- A copy of the annual financial statements of the corporation.

While at the present time the Office of the Public Trustee does not seem to be taking an active interest in the question of its jurisdiction over nonshare corporations incorporated under the *Canada Corporations Act* which carry on activities in Ontario, the prudent course for such corporations is probably to make the annual filings required by that office until the matter is clarified.

Control Issues Between a Charitable Organization and a Parallel Foundation

In most cases, a charitable organization that goes to the trouble of setting up a parallel foundation will want to have, and maintain, complete control over the foundation. This can only be accomplished through careful planning and drafting at the incorporation stage. There are various ways of dealing with the issue of control in the bylaws of the foundation. The following three models are the most popular methods of control:

I. *The charity may wish to have a "mirror" structure in the foundation so that both the charity and the foundation have the same directors and members.*

This is the most obvious method of ensuring complete control over the activities of a parallel foundation but not always the most desirable. Since the directors and members of the charity are the same as the foundation, this can result in a "stale" approach to the management of the foundation. Also, if the bylaws do not permit the admission of any other voting members or directors, the foundation will not be able to reward big donors with either a seat on the board or a membership in the foundation. This approach also means that the foundation board will be unable to invite professional advisors, who could provide advice to the foundation without charge, to sit on the board. Another drawback is that if the objects permit a transfer of funds to other "qualifying" charities, the foundation directors could be in conflict of interest if they failed to authorize the foundation to transfer funds to outside qualifying charities. Given the potential for conflict of interest, the foundation should ideally establish a funding

committee composed (at least partly) of individuals who are at arm's length to the charitable organization.

II. *An alternative to the above, is a model in which the directors of the charity are the only voting members of the foundation.*

This is an attractive method of ensuring control by the charity while at the same time leaving the option open for inviting others onto the foundation board. Clearly, control over the foundation's board is achieved by the foundation's members and is only as good as the membership chooses it to be. For example, in theory the members could decide that "outside" representation on the board is necessary. Over the passage of time and perhaps through the resignation of "insiders", the board could eventually fall under the control of the outsiders.

This is the scenario feared most by charity boards wishing to establish a parallel foundation. At first, the foundation board is closely controlled by the charity with only one or two seats being held by outsiders. As the charity's board changes from year to year, a board is elected to the charity that values outside representation and "new blood" on the foundation board. Some of these people may be close friends or business acquaintances of directors on the charity board. As the foundation board is "watered down" by outside representation, the charity slowly loses control over the foundation. The result can be loss of control over the board and a good deal of unpleasantness as the foundation's members move to remove the "offending" directors from the board. Although the members have the ultimate power to remove directors, the experience is usually traumatic and damaging to the foundation's public image.

III. *A third model, that goes a long way towards avoiding the problems of I and II, is for voting members of the foundation to be the same as the board of directors of the charity and to enact bylaws which require the members to elect a certain percentage (a majority or two thirds) of the board from among the directors of the charity.*

This control structure permits both the desired level of control from the charity's perspective and the possibility of "outside representation" on the foundation board. Loss of control could still result if the charity board decides that the bylaws of the foundation should be amended to allow for more outside representation. Since the charity's board controls the foundation an amendment could easily be passed. Although an eventual loss of control could result if the charity board decided that more outside representation were to be necessary, it is unlikely that a board would make this decision.

The above control mechanisms represent the most common ways of controlling a parallel foundation. By controlling the board of the foundation, the charity

maintains control over the foundation's constating documents. In this way, no changes can be made to the foundation's objects unless they are first approved by the board of the charity.

It is usually recommended that the board of a parallel foundation be kept as small as possible so that close tabs can be kept on those serving as directors. In other words, if outsiders are invited onto the board it perhaps goes without saying that they should be carefully selected with a view to the charity's long-term needs and aspirations. To "cement" control by the charity even further, *ex-officio* positions can be provided for within the foundation's bylaws. For example, the president, vice-president and secretary of the charity (or all of the charity's officers) could occupy the same positions *ex-officio* on the foundation board.

Summary

The establishment of a parallel foundation can be useful and sometimes critical for a charity, depending on its particular circumstances. When the decision to establish a parallel foundation has been made, professional advice is essential to achieve desirable levels of control and interplay between it and the founding charitable organization.

Once a parallel foundation has been created, the importance of co-operation between it and the charitable organization cannot be overestimated. Not only must the relationship be clearly established in the foundation's bylaws, but there must also be a co-operative rapport between the two organizations to ensure maximum benefits. The charitable organization and the foundation and their respective directors, officers and employees must realize they are all working towards the same goal—one in the short term and the other in the longer term and both should realize that it is unlikely that the foundation will produce a significant income flow to the charitable organization for several years.

As long as both parties work co-operatively, the establishment of a parallel foundation can be both fruitful and rewarding.

FOOTNOTES

1. For other recent comments on foundations see E. Blake Bromley, "Parallel Foundations and Crown Foundations" (1993), 11 *Philanthrop.* No. 4, pp. 37-52, and Sara Neely, "Update on Crown Foundations" (1994), 12 *Philanthrop.* No. 3, pp. 31-51.
2. There are, of course, other kinds of foundations. A private foundation is one that is funded usually through the donations of a single individual or family and which may or may not remain under family control. The corporate foundation is a vehicle used most commonly by a large company or organization such as a bank, to

co-ordinate corporate charitable giving. The primary purpose of this latter type of foundation is to receive contributions from a parent corporation and its subsidiaries on a tax-deductible basis and, after consolidating the funds, to distribute them to charitable organizations according to an established corporate donations policy. The Crown agency foundation, which can only be established with the help of a government, is also becoming increasingly popular since it offers attractive tax incentives to donors who are able to deduct from income 100 per cent of their gifts to such a foundation.

3. Section 149.1(12)(a) defines "control" as having more than 50 per cent of the voting shares of a corporation.
4. R.C.S. 1970, c. C-32.
5. R.S.O. 1990, c. C-38.
6. Government of Canada, Department of Industry, Science and Technology, *Information Kit on the Creation of and Amendment of Non-Profit Corporations*, May 28, 1991.
7. *Not-for-Profit Incorporator's Handbook*, prepared jointly by the Companies Branch of the Ministry of Consumer and Commercial Relations and the Office of the Public Guardian and Trustee for Ontario, Charitable Property Division (Toronto: Queen's Printer for Ontario, Revised Edition 1993).
8. R.S.O. 1990, c. C-10.
9. R.S.O. 1990, c. C-8.
10. R.S.O. 1990, c. C-39.