Registered Charities: A Primer*

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Introduction

This article deals with the federal income tax provisions that are relevant to charities in Canada, including a discussion of the privileges and obligations granted to, and imposed on charities that qualify for registration under the *Income Tax Act*.[1] [Rider I]

It also discusses the procedures for seeking registered status as a charity under the *ITA*, some of the positions adopted by the federal tax authorities, some relevant jurisprudence and some issues under other tax legislation in Canada that applies to charities. (CCRA has a web site through which a wealth of information is now available, including a list of registered charities and copies of forms, publications and releases. The web site is www.ccra-adrc.gc.ca.)

Additional comments discuss the difference between organizations that are eligible to be registered as a charity but choose not to seek registered status and organizations that are exempt as "not-for-profit" for purposes of the *ITA*.[2] The article does not deal with Crown agencies which are exempt on constitutional grounds, or corporations that are "controlled" by the Crown.[3]

The rules in the *ITA* are an over-layer that assumes the law of charities exists separately. The *ITA* does not purport to define "charity" and as a result the administrative practice and jurisprudence are a mixture of provincial case law (to the extent that the issues have been litigated within the context of provincial law) and federal case law under statutes such as the *ITA*, in which the issue is generally whether an organization should be regarded as "charitable" and is therefore worthy of registration. This is, of course, the crux of the matter when an application for registration as a charity is submitted and when CCRA reviews the ongoing eligibility of a registered charity.

Exemption From Tax

One of the main consequences of registered status for a charity is that it is exempt from tax. Under the *ITA*, no tax is payable on the taxable income of a

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"person" that is a "registered charity".[4] Since taxable income is a concept that applies for purposes of Part I only, there is a more extensive exemption available for tax imposed under Parts IV, IV.1, VI and V.1 of the *ITA*.[5] As a result, the provisions in Parts IV, IV.1 and VI.1 dealing with tax on the receipt and payment of dividends by a corporation will not apply to a corporation that is a registered charity. In addition, the tax on capital of large corporations under Part I.3 will not apply to a corporation that is a registered charity.[6] Part VI deals with capital tax and is not applicable to a corporation that is a registered charity.

A "registered charity" at a particular time means a "charitable organization", a "private foundation" or a "public foundation" within the meanings assigned by subsection 149.1(1), that is resident in Canada, was either created or established in Canada, or is a branch, section, parish, congregation or other division of such an organization or foundation, that was resident in Canada, was either created or established in Canada and that received donations on its own behalf.[7]

Consequently, the main "privilege" extended to an organization that has become a registered charity is that it is exempt from tax on all of its otherwise taxable income. As a practical matter, attaining status as a registered charity will also permit the organization to issue "official" receipts, entitling its financial supporters to tax incentives. While it is beyond the scope of this article to deal extensively with the nature of those incentives, it should be noted that, generally, individuals are entitled to a credit against tax otherwise payable, whereas corporations are entitled to a deduction in computing taxable income.[8]

The exemption will not be available to an organization that is a "charity" unless it is registered. Under paragraph 149(1)(1), unless "in the opinion of the Minister" an organization is not a "charity", its taxable income will not be exempt. This forces organizations that are "charities" to seek registered status if they wish to be exempt from tax. In those cases where fundraising is not a major factor and there is no need to issue official receipts, an organization might otherwise prefer the less stringent compliance regime that applies to "not-for-profit" organizations as opposed to those that apply to registered charities.

In the *L.I.U.N.A. Training* case,[9] the Court was somewhat critical of the arguments put forward by counsel for both parties on this issue. The question was whether a trust was exempt. Counsel appeared not to have focused on the issue until the judge raised it.[10] The judge stated that if the entitlement to an exemption depends on an organization being a charity, the court hearing the case must make that determination, and cannot leave it to counsel to agree. The judge stated as well that where the issue involves an appeal from a refusal of CCRA to register a charity under section 149.1 of the *ITA*, the appropriate tribunal to hear the issue is the Federal Court of Appeal pursuant to subsection 172(3). The judge also affirmed that where a person seeks exemption under

paragraph 149(1)(1), one of the conditions to the entitlement is that in the opinion of the Minister it must not be a charity within the meaning of subsection 149.1(1). In other words, it must not be a charitable organization or a charitable foundation and the Minister must form that opinion. It is not sufficient that the Minister not be of the opinion that it is a charity. Rather there is a positive requirement for the Minister to form the opinion that it is *not* a charity.

The judge discussed whether an organization seeking exemption under paragraph 149(1)(1) should first apply to CCRA seeking registration as a charity and only upon being rejected be in a position to establish affirmatively what the opinion of the Minister is for this purpose. Counsel for the trust stated that it was not his practice and he considered it to be a waste of time, to seek registration in circumstances where it appeared to be obvious that registration would not be granted. As the judge pointed out, there was no evidence at all before him about the opinion of the Minister on the point and no admission was made in the pleadings or otherwise by counsel for the Minister. The judge ultimately found that the Minister should have pleaded this issue formally, to put the trust on notice, stating that it would be unfair to impose on the organization claiming exemption under paragraph 149(1)(1) the onus of establishing a fact (i.e., the state of mind of the Minister) when it could easily be established by the Minister.

The judge went on to state that if one of the conditions in applying or not applying a particular provision in the *ITA* is the opinion of the Minister, then the Minister has a positive obligation to form that opinion and to communicate it to the taxpayer. He said that failure to form an opinion cannot, consequently, be set up as a basis for denying the claim for exemption. Since the Minister had failed to fulfil that obligation, the judge found there was no onus on the taxpayer to establish that the Minister was of the opinion that it was not a charity.

Finally, in dealing with the merits, the judge stated that in forming his opinion, it must be presumed that the Minister would have done so on a "correct legal basis" and if the Minister were properly instructed as to the law, he would have concluded that the trust was not a charity. Presumably, if the Minister had pleaded that the trust was a charity, the Court would have been required to determine whether the opinion was correct and would have found in favour of the trust. It seems clear that the Minister cannot arbitrarily form the opinion that an organization is a charity in order to deny the exemption.

I mention all of this to illustrate the interplay between the regime for registered charities in section 149.1 and related provisions and the regime for organizations that are "not-for-profit" but might nevertheless, arguably be regarded as "charities". Unfortunately, CCRA does not appear to have developed any well-defined practice in this area and therefore organizations that have assumed they are exempt under paragraph 149(1) may find that they are denied exempt

status after the fact because the Minister alleges that they are charities that should be registered.

If any of the objects are charitable, it will be important to determine whether the organization will be denied an exemption on this basis if it is not registered. In some cases, it will be advisable to "taint" the purposes and activities, to ensure the organization is not a "charity" if reliance is to be placed on paragraph 149(1)(1).

Categories of Charities

A number of concepts have been set out in the *ITA* to delineate the scope of the activities that can be carried on by an organization that seeks to maintain its status as a registered charity or to become a registered charity in the first place. Every registered charity will be categorized as one (but not more than one) of the three main categories set out in the definition. In other words, a charity will be treated as a charitable organization or as a charitable foundation, and if it is a charitable foundation, it will be treated as either a public foundation or a private foundation. Different rules will apply, depending on the category in which the charity is placed. Categorization may change over time, if circumstances change.

When registration is first granted, CCRA will designate the charity as a charitable organization, a public foundation or a private foundation. This designation will be made on the basis of information submitted with the application. Some of the criteria are discussed below. In each case, a decision should be made when the charity is being formed and organized and when the application is being submitted, about the category in which it should be placed when registered. This status will have a direct bearing on the ability of donors to take advantage of certain tax incentives and on the level of compliance required from the charity. For instance, the incentives available to donors for gifts of marketable securities will not apply to gifts to private foundations.[11]

CCRA has recently issued RC 4108 *Registered Charities and the Income Tax Act,* which replaces Revenue Canada's former Information Circular IC 80-10R. This publication contains a comprehensive analysis of the views of CCRA on a variety of issues, including maintaining status as a registered charity, the differences between a charitable organization and a charitable foundation, the concept of associated charities, the issuance of official receipts, maintenance of books and records, filing annual returns, disclosure of information to the public by CCRA, political activities, business activities and foreign activities, disbursement quotas, revocation, audits and other matters.

(a) *Charitable Organizations*

In order to be qualified for registration, an organization must meet a basic testing of whether it is organized and operated exclusively for "charitable" purposes. The meaning of the term "charitable" in this context is not precise.

Assuming the organization (which need not be incorporated, and therefore can be a trust or unincorporated association as well as a corporation) can satisfy CCRA that it is "charitable" for this purpose, it will be treated as a charitable organization if it meets the following requirements:

(i) all of its resources must be devoted to charitable activities that it carries on or is deemed to carry on;

(ii) for this purpose, it will be deemed to be devoting its resources to its charitable activities to the extent that it carries on a "related business", it disburses not more than 50 per cent of its "income" to "qualified donees" or it disburses "income" to another registered charity that has been designated in writing by the Minister as being "associated" with it;[12]

(iii) it must devote substantially all of its resources to charitable activities that it carries on itself but if it devotes part of its resources to political activities it will be considered to be devoting those resources to its charitable activities to the extent those political activities are "ancillary and incidental" to its charitable activities and they do not include the direct or indirect support of, or opposition to any political party or candidate for public office;[13]

(iv) no part of the income of the organization can be payable to, or otherwise available for the personal benefit of any proprietor, member, shareholder, trustee, or settlor;

(v) more than 50 per cent of the directors, trustees, officers or "like officials" of the organization must deal with each other and with each of the other such officials at arm's length;

(vi) no more than 50 per cent of the "capital" can have been contributed or otherwise paid to the organization by one person or members of a group of persons who do not deal with each other at arm's length. For this purpose, a reference to a person or members of a group does not include a reference to Her Majesty in right of Canada or Her Majesty in right of a province, a municipality, another registered charity that is not a private foundation or any not-for-profit organization that is described in paragraph 149(1)(1);

(vii) the organization must not run afoul of the "revocation" rules;

(viii) specifically, it must not carry on a business that is not a "related" business;

(ix) in addition, it must expend in each year on charitable activities that it carries on itself, or by way of gifts that it makes to "qualified donees", sufficient amounts to meet its "disbursement quota";

(x) an amount paid by a charitable organization to a qualified donee that is not paid out of its "income" is deemed to be a devotion of a resource to a charitable activity. This is a permissive provision, intended to allow a charitable organization to transfer capital amounts to other registered charities and to other "qualified donees".[14]

A charitable organization can jeopardize its registered status in a number of ways. If it fails to devote all of its resources to charitable activities or to activities that are deemed to be charitable activities, it risks being de-registered. If it fails to expend a sufficient amount annually to meet its "disbursement quota" it risks being de-registered. If it carries on a business that is not "related" to its charitable activities, it risks being de-registered. In this regard, there is no comprehensive definition of "related", although there are provisions which deem certain volunteer activities, such as rummage sales and bazaars, to be acceptable.[15] [Rider II]

(b) *Charitable Foundations*

By definition, a "charity" means either a charitable organization or a charitable foundation.[16] A charitable foundation means a corporation or trust (but not an unincorporated association or other form of entity) that is constituted and operated exclusively for "charitable purposes", as long as no part of its income is payable to or otherwise available for the personal benefit of any proprietor, member, shareholder, trustee or settlor, and provided it is not a charitable organization. In effect, this is a "default" definition. As long as the organization meets the "charitable purposes" test and other tests, it will be a charitable foundation if it is not a charitable organization. Generally, CCRA regards charitable foundations as "conduits" for raising funds and disbursing them to other organizations. There is no requirement that a charitable foundation devote substantially all of its resources to its own activities.

The *ITA* does not attempt to outline what is meant by "charitable purposes", although it does expand the concept by providing, for instance, that the term will include disbursements of funds to qualified donees.[17] But for this expansive approach, there might be a concern that spending money by giving it to other registered charities is not in and of itself a charitable purpose.

As noted above, all charitable foundations must be either public foundations or private foundations but they cannot be both. However, the status of a charitable foundation may change from private foundation to public foundation, depending on the particular circumstances.

(c) *Public Foundations*

A private foundation is a charitable foundation that is not a public foundation. Again, this is a definition by default. It is therefore necessary to consider what is meant by the term "public foundation". For this purpose, a public foundation will be a charitable foundation if more than 50 per cent of the directors, trustees, officers or like officials deal with each other and with each of the other

directors, trustees, officers or officials at arm's length (this test is similar to the test for a charitable organization) and not more than 50 per cent of the capital contributed or otherwise paid in to the foundation has been contributed or paid in by one person or members of a group of persons who do not deal with each other at arm's length. This is similar to the test for a charitable organization.

Consequently, where the tests for "diversity" among the directors or trustees and the source of its capital are met, an organization will be classified as a charitable organization if it devotes its resources to charitable activities (or is deemed to do so) and will otherwise be a public foundation.

In general terms, the rules contemplate that public foundations will have a degree of independence, whereas a private foundation will generally be linked to one person or a group of persons who do not deal with each other at arm's length. A typical "family" foundation will almost invariably be "private".[18]

In some cases, problems can arise with this type of classification. For example, there have been instances of very large gifts being made by one person to a public foundation such as a local community foundation. That gift in and of itself could conceivably cause the foundation to lose its status as "public" and become "private" because of the 50 per cent of capital test. Fortunately, CCRA has to date taken a relatively benign approach and has indicated that provided this occurs only on an isolated basis, it will not re-classify a public foundation and treat it as a private foundation for this reason alone.

A public foundation and a private foundation can each lose their status if they fail to meet their disbursement quotas or run afoul of certain other requirements. A public foundation can lose its registered status if it carries on a business that is not a related business (this test is similar to the test for a charitable organization); if it fails to meet its disbursement quota for the year (this also is similar to the test for a charitable organization, although the disbursement quota is different); or if it acquires "control" of any corporation or incurs 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 its charitable activities.[19]

Under the *ITA*, the Minister has power to designate a charity that would otherwise be a private foundation as a public foundation[20] and can impose terms and conditions when designating such a foundation as a public foundation. Where the designation is made, the charity is thereafter treated as a public foundation, until such time, if any, as the Minister revokes the designation.

An application must be submitted on form T3011 for organizations seeking a designation as associated charities. CCRA has stated that it will approve a designation if it is satisfied that the charitable aims or activities of each charity are substantially the same. If they are different, a designation may still be granted with respect to a specific joint project. In that event, the application

should explain the nature of the project, how it will operate, and the way in which each of the registered charities expects to achieve the common goal. A charitable foundation that is granted associated status with another registered charity cannot be re-designated as a charitable organization solely on the basis of its status as an associated charity.[21]

(d) *Private Foundations*

Similarly, a private foundation can lose its registered status if it carries on any business (unlike a charitable organization and a public foundation, a private foundation does not have the ability to carry on a "related business", whatever that term means). As is the case for charitable organizations and public foundations, a private foundation can lose its registered status if it fails to meet its disbursement quota. As in the case of a public foundation, it can lose its status if it acquires control of any corporation or if it incurs inappropriate debts, as outlined above.

I do not propose in this article to delve more deeply into the intricate rules dealing with the disbursement quota or some of the relieving provisions to deal with transition in the first years of a charity that raises funds. Those readers who are interested in pursuing this in more detail are advised to review RC 4108.

Foreign Operations

In simple terms, a charitable organization is essentially an organization that directly carries on a substantial level of charitable activity itself. It may carry on that activity in Canada or, if it intends to support foreign causes, it must carry on the foreign activity directly. It will not be permitted to make payments directly to other charitable organizations that do not qualify as donees unless it does so through a form of "agency" or "joint venture" arrangement; otherwise, the charity will not be regarded as devoting its resources to its own charitable activities. As a result, CCRA expects charitable organizations to enter into appropriate arrangements where assistance is being provided to support causes in countries other than Canada. For example, a catastrophic earthquake in India would undoubtedly elicit a flood of financial assistance from Canadian charities.

Typically, larger organizations in Canada will have their own resources abroad in the form of staff members, vehicles and other infrastructure, to deliver the support directly. Smaller organizations will enter into arrangements with local charities, who will act on behalf of the Canadian charity. CCRA has outlined its views on this issue in RC 4106, *Registered Charities: Operating Outside Canada*.[22]

CCRA has indicated that one of its concerns about foreign operations is that the tax incentive system in Canada for gifts to Canadian registered charities may be used to finance illegal or morally offensive operations in other countries, e.g., the activities of terrorist groups. As a result, CCRA may from time

to time undertake audit proceedings where the objects of a Canadian registered charity clearly indicate an intention to support various types of activities in foreign countries. [Rider III]

New legislation was introduced to deal with the revocation of the registration of charities that are alleged to be raising funds in Canada to promote terrorism. As stated by a journalist, "in an uncharted collision between political reality and fundamental justice, the federal government is introducing tough new charity legislation just as the Supreme Court prepares to hear a case that challenges many of that bill's underlying methods and motives. Even though it will be months before the legislation becomes law or the court rules, politicians, lawyers and shadowy residents of the intelligence community are already scrambling to grasp the implications.[23] The new rules will give the Canadian Security Intelligence Service (CSIS) sweeping power to strip charitable status from local groups supporting violent political movements overseas. The message to charities and their advisers is clear. Any charitable organization in Canada that has any connection with activities outside Canada that even

will include furthering the aims of a political party, promoting a political doctrine, persuading the public to adopt a particular view on a broad social question and attempting to bring about or oppose changes in the law or government policy. CCRA has also stated that purposes that are so broad as to allow for unlimited political activity will not be acceptable. (In addition to T4053, see also CCRA's RC 4107, *Registered Charities: Education, Advocacy and Political Activities*.) [Rider V]

The Meaning of "Charity"

At common law, the starting point for the understanding of the special treatment and requirements for qualification as a charity, is *Pemsel*[24] which was based in large part on a Statute enacted during the reign of Queen Elizabeth I,[25] which sets out a number of specific purposes which are to be regarded as charitable. This illustrates one of the problems in attempting to apply an ancient statute and outdated jurisprudence to a rapidly evolving world that is becoming increasing more globalized and adapting to the fast moving pace of technology. It is beyond the scope of this article to deal extensively with the case law that analyzes the meaning of "charity" at common law, but the following is a brief analysis of the salient points:

The Preamble to the Statute lists what were considered to be charitable purposes when it was enacted:

(a) the relief of aged, impotent and poor people;

(b) the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities;

(c) the repair of bridges, ports, havens, causeways, churches, seabanks, and highways;

(d) the education and preferment of orphans;

(e) the relief, stock or maintenance of houses of correction;

(f) marriage of poor maids;

(g) supportation, aid and help of young tradesmen, handicraftsmen and persons decayed;

(h) the relief or redemption of prisoners or captives; and

(i) the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers and other taxes.

This list is not exhaustive and for many years the courts have considered that purposes within the spirit and intendment of the Preamble may be charitable even if they are not specifically listed. This was the basis for the decision in *Pemsel*.

The Supreme Court of Canada gave us some guidance on several of these issues in *Vancouver Society*.[26] The Court dealt with the meaning of "charitable" at common law and refused to expand the common law, stating that it was up to the legislators to do so. Consequently, under current "federal" laws relevant to the *ITA* for this purpose, we are left to look to the governing law in the particular province (or provinces) in which the charity operates.

The traditional four "heads" of charity are therefore relevant. These are:

(a) the relief of poverty;

(b) the advancement of education;

(c) the advancement of religion;

(d) other activities that are of benefit to a significant part of the public, in a way that the law regards as charitable.

The courts in Canada have consistently had the most difficulty in delineating the scope of the fourth head of charity. In a case involving a society formed in British Columbia to develop, operate and own a free, publicly accessible community computer facility providing the broadest possible range of information and possibilities for the exchange of experience, ideas and wisdom, and to take advantage of the internet technology, the Court took comfort from the Preamble to the *Statute of Elizabeth* and drew an analogy between the bridges, ports, causeways and highways on the one hand and more modern "means of communication".[27] It held that the provision of free access to information and to a means by which citizens could communicate with one another on whatever subject they might wish to do so is a type of purpose similar to those which were held in the past to have been charitable and within the spirit and intendment of the Preamble to the *Statute of Elizabeth*. This is the type of contorted thinking that has caused difficulty for many organizations seeking registered status, since CCRA and the courts have been inclined to try to force them to "shoehorn" themselves into a restrictive definition.

In *Vancouver Society*, the Court dealt with a claim that the Society met the test under the "educational" head as well as under the fourth head. Unfortunately, although many of the Society's activities were clearly "on side", the Court found that there were certain activities as well as purposes that were not "on side" and therefore the appeal failed because the purposes were not "exclusively" charitable. Nevertheless, the decision does provide some useful guidance as to the scope of the meaning of "education".

The *Vancouver Society* case should be read very carefully by anyone who is interested in a real understanding of the problems that must be faced in attempting to obtain registered status for a charity. It contains a detailed analysis of much of the pre-existing jurisprudence, as well as an analysis of the distinction between a primary purpose and an incidental or ancillary purpose.

Unfortunately, CCRA does not appear to be following *Vancouver Society* to the extent that it should when it reviews applications for registration. A careful reading of the case shows that although there were five purposes in question, the fact that not all of them were charitable was not in and of itself fatal. The Supreme Court was prepared to acknowledge that incidental and ancillary political purposes were acceptable, as were incidental and ancillary fundraising purposes. One of the fundamental problems was vague and broad drafting of the objects and, in particular, the use of the word "conducive". The Court felt that this opened the door to activities that potentially would go beyond those that would support charitable purposes. Moreover, while expanding the concept of "education" to include activities that are not necessarily limited to formal training in a classroom setting, the Court also made it clear that there was an element of public benefit for a group consisting of minority and immigrant women. However, immigrant women as a group were considered to be unworthy of "charity" without meeting some further criterion, such as refugee status.

In many cases, as a practical matter, CCRA is reluctant to approve activities for which there is no clear precedent. I have encountered many situations in which I have been told that since there is no case directly on point, CCRA is reluctant to approve an application for registration. This in effect amounts to "proving a negative".

Clearly, there is a concern at CCRA that once registration is granted, it is difficult for CCRA to police the charitable sector. As a result, there appears to be a concerted effort to "raise the bar" by making it more difficult for organizations to become registered if they have purposes and propose to carry out activities that are in any way questionable.

The office of the Public Guardian and Trustee in Ontario has developed a list of "standard" objects that will be accepted for incorporation in Ontario on an expedited basis. These were cleared in advance with CCRA and, *provided* that all of the other requirements of CCRA are met, organizations that are prepared to follow a "pre-approved" set of objects will generally not encounter difficulty. The practical problem is that these pre-approved objects are generally very narrow and frequently they do not encompass the types of activities that organizations wish to pursue. Moreover, even where the objects are acceptable, it will be important that the statement of proposed activities, which must also be submitted as part of the application process, be acceptable to CCRA.

There are instances in which provincial courts have found that an organization is charitable and CCRA has taken a different position. Many of these cases involve exemptions from property tax. In a leading case involving the Laidlaw Foundation, an Ontario Court found, on a passing of accounts which did not involve the organization itself, that an amateur athletic association was charitable, notwithstanding that CCRA took the position that it was not charitable.[28]

The Ontario Court held that the determination of charitable status in Ontario should not depend on whether the object under consideration was within the spirit and intendment of the *Statute of Elizabeth*. It referred to a provincial statute which contained its own definition of "charitable uses" and included the relief of poverty, education, the advancement of religion and any purpose beneficial to the community, not falling under the foregoing heads.[29] While noting that this appeared to be an attempt to follow the *Statute of Elizabeth*, the Court held that it should not be limited. It also referred to the statutory restrictions on charities operating in Ontario that wish to hold land for non-charitable purposes.[30]

The Court stated that the course of provincial legislation in Ontario led clearly to the conclusion that the Ontario Legislature consciously changed the law for the purpose of preventing the English doctrine from being applied in Ontario to determine whether any purpose beneficial to the community, not being the relief of poverty, education or the advancement of religion, was in the legal sense a charitable purpose.

This case illustrates the problem in a federal country such as Canada in leaving the determination of issues that are essentially matters of provincial law to the federal court system and to a federal agency such as CCRA. It also illustrates that the law could very well be different among the provinces, raising the distinct possibility that there is not a level playing field across the country, if the federal court, in reviewing income tax issues, is required to follow provincial law.[31]

Member Benefits

As noted above, an organization cannot provide any benefits out of its income to its members if it wishes to be registered. This raises a number of issues with respect to the circumstances in which a "benefit" will be considered to have been provided to a member. CCRA takes this into account in reviewing applications and the application form itself requires disclosure of whether there are any benefits provided to members that would be fatal. CCRA has acknowledged that an organization may pay for services rendered or other expenses that are associated with its normal operations.

Generally, provincial and federal law dealing with incorporation will prevent a corporation from being formed as a "not-for-profit" corporation unless there is an express statement in the letters patent or other constating document preventing the corporation from providing benefits to its members.

A collateral issue arises where directors of a corporation wish to be paid for their services. A charitable organization must devote all of its resources to its charitable activities. There is a concern that paying a director, who might be expected to perform services gratuitously, is not a proper application of charitable resources. In addition, the Public Guardian and Trustee in Ontario has taken the position, based on some jurisprudence, that it is inappropriate in

the absence of a court order for a director to be paid, either for acting as a director or in any other capacity. In effect, this prevents professionals, such as accountants and lawyers, from being paid, or from being members of firms that are being paid, for services rendered in a normal commercial relationship with the charity. It will be important that there be no arrangements or understanding pursuant to which members or directors will personally benefit in any way from a charity in a manner that would disqualify the organization from meeting the test in the *ITA* or subject it to criticism from the Public Guardian and Trustee in Ontario. In the instructions for the completion of the application for registration, CCRA states that it needs sufficient information to establish whether a transaction would be consistent with the common law definition of charity and whether it would also comply with the provisions in the *ITA*. It refers to a situation in which the organization intends to make a loan to a director or has previously made a loan to a director. It asks for information about the terms of any such loan, including details about the rate of interest, the repayment schedule and whether any guarantees or other security have been provided. It also asks for information about the position of the individual within the organization. CCRA also refers to a situation in which an individual serves on the board and also serves on the board of a company that enters into a commercial arrangement with the charity, such as a landlord that rents space to the charity. CCRA will require information about the terms of a lease or other "financial transactions" with the directors, or with persons related to directors.

Registering a Charity

(Form T2050 which CCRA requires when reviewing an application for a registration should be read together with T4063.)

It is important to recognize that in *Vancouver Society* the Supreme Court distinguished between the purposes of an organization and the means used to attain its purposes. In other words, there is a distinction between the end that is sought and the means used to try to attain that end. In the charitable sphere, this is the difference between charitable activities and charitable purposes. Notwithstanding the distinction drawn by the Supreme Court, it is clear that CCRA takes a relatively narrow view. CCRA states that in reviewing the application it needs to know how the organization will achieve each of the objects listed in its governing documents and requires a description of the charitable activities that the applicant will carry out itself as well as details of the resources (both financial and material) that it intends to make available to qualified donees to assist them in carrying out their charitable activities.

In T4063, CCRA reviews a number of issues, including the standards it uses when reviewing applications, the concept of "charitable purposes", the factors that will disqualify an organization from registration, the types of organizations or activities that are not "charitable at law" and the application process itself,

including the completion of the form, and the type of supporting documentation that must be submitted, depending on the nature of the legal entity involved. As of January 1, 2001, CCRA no long accepted application forms that had been completed in the old "short form" format. The current application form is much more comprehensive and requires much more detail.

With respect to proposed activities, CCRA requires information about each of the objects listed in the governing documents, and requires a description of the charitable activities that will be carried out by the organization and details of the financial and material resources that it intends to make available to qualified donees to assist them in carrying out their charitable objects in appropriate situations. The applicant is expected to provide sufficient detail to assist in determining whether its activities are truly charitable. CCRA has stated that most delays in processing applications are the result of information that is insufficient because it is too broad or too vague. It insists upon receiving sufficient information to give it a clear understanding of what the applicant really intends to do. CCRA will require some details about fundraising activities or administration at the time the application is submitted. It will also require answers to certain questions about the performance of the charitable purposes. For instance, it will require details with respect to the way in which activities such as scholarships and bursaries will be handled. Where activities are to be carried on outside Canada, CCRA will require information about the countries and locations in those countries where the activities are to be carried out, including an area map, if necessary. It will also require information about the infrastructure and whether the activities are to be carried out by volunteers or employees, through an agent or through some other type of arrangement with entities in the other jurisdiction. It will be necessary to describe the "control measures" that will be established if an agent is used in another jurisdiction and, where appropriate, to provide the name and description of any foreign organization that will receive funds or goods.

A careful review of the application form indicates that many of the questions are designed to provide CCRA with the information that was not readily available to it from previous forms when it was attempting to determine whether an applicant was eligible for registration. The present form includes detailed information about potential political activity, fundraising activities, etc.

In drafting the trust agreement, constitution or letters patent for a charity, the questions in the application form should be carefully considered. There is no point in forming an organization and setting out its objects and purposes with a view to seeking charitable registration if those objects and purposes will not comply with the requirements in the *ITA* or CCRA's administrative position. CCRA is prepared to review objects in draft form. In T4063, CCRA states that if draft documents are submitted, all other documents and information required on the application form must also be provided. It will not make a determination

regarding registration solely on the basis of a draft document or on other partial information. It will consider draft documents on a one-time basis only, on the understanding that any further contact will be based on the actual governing documents, after the organization has been formed.

In T4063 CCRA outlines several different circumstances, including those situations where the draft documents are approved, where the draft documents are not approved and where the organization has been formed but revisions are proposed to the existing governing documents in the course of the application. Each case should be reviewed carefully and CCRA's position, as set out in T4063, should be carefully considered.

CCRA has stated that in order to qualify for registration, the organization must show that its activities and purposes provide a "tangible benefit" to the public, that those people who are eligible for those benefits are either the public as a whole or a significant section of the public, and are not a restricted group or a group whose members share a private connection, such as a social club or a professional association with a specific limited membership. In addition, it states that the activities must be legal and must not be contrary to "public policy".

Notwithstanding CCRA's assertion that most delays in processing applications are the fault of the applicant, I believe many who practice in the area of charity law have found for several years that there are long delays at CCRA in processing applications that are fairly straightforward. This appears to result from a combination of lack of appropriate manpower at CCRA and lack of an appropriate streamlining or priority system. The bottom line is that anyone seeking registration should be prepared for a long wait before the file is assigned and before it is reviewed. Even then, there is a real possibility that the initial review will produce a negative result, requiring submissions to address a number of problems identified by the examiner. This has caused a high level of frustration on the part of many who are dealing with CCRA on a regular basis.

For these and other reasons, the current discussions dealing with alternative approaches [Rider VI] to the regulation of the entire charity sector are welcome. It is beyond the scope of this article to deal with those initiatives, but they include the possible creation of a new charity commission, along the lines of the commission established in England and Wales. Another approach involves the creation of a separate Canadian charity tribunal.[32] [Rider VII]

The Canadian Centre for Philanthropy (CCP) has conducted a survey of a number of organizations that have been unsuccessful in seeking registered status.[33] According to its statistics, in 1994–1995, 85 per cent of applications were successful. By 1998–1999, this had dropped to 67 per cent. It seems quite clear that there has been a significant shift in the attitude of CCRA. Organizations that were registered previously might in many cases have difficulty being registered today. This raises a concern for organizations that are de-registered for technical reasons, such as failure to file an annual form T3010. I am told

there are circumstances in which organizations that were registered many years ago and that have been de-registered on technical grounds have been denied re-registration, simply because their current purposes are no longer perceived to be acceptable. This means that there is no longer a "level playing field".

It appears as well that from a social policy perspective, the public has changed its perception of the role of charities. In the past, charities were regarded as providing stop-gap solutions, not attempting to solve problems. Now, more and more, charities *are* expected to provide solutions. This requires a creative approach to the types of activities and purposes for which new organizations are being formed. Unfortunately, CCRA does not seem to be prepared to change with the times, notwithstanding the comments in *Vancouver Society* about the distinction between incidental and ancillary purposes and "primary" purposes.

I understand that CCRA may produce an annual report in future, providing details (without names) of those situations in which applications have not been approved. It seems clear that in many cases CCRA, as a practical matter, does not take the step of actually refusing an application, since the applicant frequently is simply worn down through attrition and decides not to proceed. The only legal basis for challenging the position adopted by CCRA when the application has been refused, is to appeal to the Federal Court of Appeal and many organizations are not prepared to take the matter that far. This results in a high degree of unaccountability on the part of CCRA officials. [Rider VIII]

The CCP survey analyzes a number of situations in which applications were not accepted. I understand the results of the survey suggest that an applicant would be well advised not to volunteer information that is not required as part of the application. Applicants should also be aware that CCRA routinely examines web sites and other sources of information in addition to the information that is submitted by the applicant.

In completing the form for application, an organization should be aware that all information other than the information about the addresses and occupations of the directors set out in the "confidential" section, will be put into the public realm. Information regarding proposed activities should be prepared with this in mind.

It is of more than passing interest to many of us who have practised in the area of charity law for a number of years that CCRA's views (expressed when its predecessor was called Revenue Canada Taxation) were summarized in a brief article.[34] CCRA stated that it is the absence of definitions of charitable purposes and charitable activities in the *ITA* that often leads to "discussion between Revenue Canada Taxation and applicants for registered charitable status". It went on to state that with no other statutory definitions of these terms, which are among the most critical in charity law and its administration, the charities examiners rely on the meanings established at common law. Refer-

ence was made to the Preamble to the *Statute of Elizabeth* and the fact that there had been a growing dependence in the 20th century on common law drawn from that statute. The article confirmed that the examiner would refer to the four classes of charities set out in *Pemsel* and the requirement that the purposes fall within at least one of those four classes. The article, which was written in 1986, harkens back to what appears to have been a much simpler time, when the registration of charities was a much less adversarial undertaking.

Qualified Donees

The *ITA* refers to "qualified donees" to whom transfers from registered charities are permissible. In addition to other registered charities, qualified donees include a registered Canadian amateur athletic association, certain low cost housing corporations providing accommodation for the aged, a Canadian municipality, the United Nations or any of its agencies, a university outside Canada if it is listed in the regulations as being a university whose student body ordinarily includes students from Canada, the federal Crown and the provincial Crowns, and certain foreign charities if the federal Crown has made a gift to them within the preceding 12 months. This is a means by which the federal government can annually designate foreign charities for special treatment.

In most cases, registered charities will tend to make gifts to other registered charities or perhaps to the federal or provincial Crown or a municipality. There has been an interesting controversy with respect to the position CCRA has taken concerning the ability of registered charities to support foreign charities which are not qualified donees. Technically, the requirements in the *ITA* dealing with disbursement quotas for charitable foundations do not contain any express rule dealing with the "additional" funds that remain after the disbursement quota is met. It can certainly be argued that as long as the organization meets an overall "charitable" test for its purposes and activities, there is no requirement that the activities be carried out in Canada or that the purposes be fostered in Canada. For this reason, a number of charitable foundations, including private foundations, have in the past, having met their disbursement quotas, made grants to foreign charities that are not qualified donees. A foreign charity cannot be a qualified donee because it is not capable of becoming a registered charity. CCRA has taken the view that it is not appropriate for a registered charity to support a foreign charity through grants, even if the disbursement quota has been met. However, in a test case in the Ontario courts, when this position was challenged, CCRA effectively abandoned its position, acknowledging, at least in that one situation, that there was no support in the *ITA* for its position and indicating that it would try to have the *ITA* amended to support its position. [Rider IX]

Penalty Taxes

There are several situations in which a registered charity or a charity that has had its registration revoked will be subject to special penalties. Where registration is revoked, the charity may be required to pay tax no later than one year after the date of revocation. The tax is generally based on the fair market value of the assets on the day that is 120 days before the notice of proposed revocation was mailed (the "valuation day"), together with the amount of receipted gifts from other donations after that time, less amounts given to qualified donees, amounts spent on charitable activities, amounts spent on reasonable winding up costs and amounts spent to satisfy any debts that were outstanding on the valuation day. A charity whose registration has been revoked is required to file form T2046, whether or not any tax is payable. There are provisions for joint and several liability of recipients of property from a charity whose registration has been revoked.[35]

In addition, where certain "non-qualified investments" in the form of debt, shares or a right to acquire shares are held by a private foundation, in certain non-arm's-length situations, it is exposed to a special tax if the investment does not yield a minimum rate of return.[36] This is in addition to the requirement that the "disbursement quota" for a charitable foundation include a minimum return of 4.5 per cent on certain assets. In some cases, particularly where gifts have been made subject to requirements that the capital be maintained in perpetuity or for a stipulated period of time, achieving this rate of return may be difficult, particularly for smaller charities.

There is a further tax on a charitable foundation if it transfers property with a net value that is more than 50 per cent of its assets to charitable organizations *if* it is reasonable to consider that the main purpose of the transfer is to reduce the foundation's disbursement quota.[37]

If a charity receives a gift of "cultural property", and disposes of it within 10 years (or five years for dispositions prior to February 23, 1998), there is a tax of 30 per cent of the fair market value of the property. This is designed to prevent the disposition of cultural objects for which tax relief has been given to a donor under special incentives. This same penalty tax will apply where the subject matter of the gift is "ecological property" rather than cultural property.[38]

Registered charities are also subject to special provisions in Part XI of the *ITA*. These rules apply to a variety of "exempt" entities, including, for certain purposes, persons that are exempt from tax on their taxable income under Part I. This would include a registered charity. Under section 206.1, where a registered charity agrees to acquire a share of a corporation from a third party at a price that may differ from its fair market value at the time the share may be acquired, the charity is subject to a monthly tax during the term of the agreement, equal to the amount of dividends paid on the share less the amount

of dividends actually received by the charity on the share. This is designed to prevent inappropriate trafficking in shares to permit charities to "sell" taxable dividends. But for this provision, it might be possible for a public corporation to acquire shares of corporations temporarily from a charity on terms such that they could be bought back at a bargain price by the charity. Since the corporation would not be taxed on the dividends, there would otherwise be a potential for tax avoidance.[39]

The rule is intended to discourage tax-exempt entities such as registered charities from temporarily transferring shares to persons who may be able to receive dividends on those shares on a tax-favoured basis. In addition, it will apply where there is a delay in the acquisition of a share by the registered charity. The rule does not apply where the agreement is with the corporation whose shares are to be acquired or to an agreement that is a consequence of the acquisition or writing by the charity of an option listed on a prescribed stock exchange.

Amendments to the *ITA* now expose charities and their advisers to significant civil penalties in certain circumstances.[40] These rules are a direct result of an initiative announced by the Department of Finance in response to what has been perceived to be abusive tax planning, largely relating to the valuation of gifts-in-kind. In light of other changes to the *ITA* specifically prohibiting certain types of planning involving "personal use property", many legal advisers feel the penalty provisions are too far reaching.[41] CCRA has put out Information Circular IC01-1 dealing with the third party penalty provisions. It has also announced that it intends to centralize all proposed assessments of civil penalties through a head office committee, similar to the "general anti-avoidance rule" or GAAR committee that was established to provide a "level playing field" across the country and prevent inconsistencies among local tax offices. Charities and their advisers should be aware of the potential for civil penalties and review these provisions and CCRA's position papers carefully.

Revocation of Registration

Under subsection 172(3), a charitable organization, private foundation or public foundation has the right to appeal where notice is given by the Minister of a proposal to revoke its registration. There is also a right of appeal where the Minister refuses to designate a registered charity as a public foundation under subsection 149.1(6.3).

Under subsection 168(1), where a registered charity applies in writing to have its registration revoked or ceases to comply with the requirements of the *ITA* for continuing registration, fails to file the required information returns, issues a receipt that is not in accordance with the *ITA* or the regulations or that contains false information or fails to comply with record keeping requirements, the Minister is entitled to send notice by registered mail proposing to revoke the registration. Pursuant to subsections 149.1(2), (3), (4) and (4.1), the Minister

may, consistent with section 168, revoke the registration of a charitable organization, public foundation or private foundation for any reason set out in subsection 168(1), or, in addition, where the charity either undertakes an inappropriate action or fails to meet its disbursement quota. Under subsection 149.1(4.1) where a registered charity that has made a gift to another registered charity in circumstances in which it is reasonable to consider that one of the main purposes for making the gift was to "unduly delay the expenditure" of amounts on charitable activities, its registration may be revoked.

Under subsection 168(2), where the Minister gives notice proposing to revoke the registration, he may publish a copy of the notice in the *Canada Gazette*, whereupon the registration is formally revoked, subject to appeal.

Under subsection 172(4), where the Minister has not notified an applicant for registered status within 180 days after the filing of the application, the Minister is deemed to have refused to register the charity as a charitable organization, private foundation or public foundation, thereby triggering the right to begin the appeal process.

Pursuant to section 180, an appeal under subsection 172(3) is to be instituted by filing a notice of appeal within 30 days from the time the decision refusing the application for registration or the decision to revoke the registration is made or the notice of intent to revoke registration is mailed, as the case may be.

In *Alliance for Life*,[42] the Minister had registered the organization in 1973 [Rider X] but subsequently, following an audit, alleged that it was no longer eligible for continued registration. After consultations, attempts were made to revise the objects in order to satisfy CCRA. A separate noncharitable organization was established to carry on the activities which the Minister felt were offensive. The Minister subsequently approved certain proposed amendments to the objects which were confirmed by supplementary letters patent. On a further audit, the Minister took the position that the revised activities were not sufficiently segregated from those of the separate organization and therefore were not exclusively charitable. The Minister gave notice of an intention to revoke and an appeal ensued. The charity was unsuccessful in alleging that there had not been "fairness" in the process. In the end, on the merits, the Court held that certain activities were "political" and were not "ancillary and incidental" to the overall activities. As a result, despite the objects set out in the supplementary letters patent, the Court found that the true mission was that of advocating strongly held convictions on important social and moral issues in a one-sided manner, to the virtual exclusion of any equally strong opposing views. In addition, the Court found that these activities were not saved by the relieving provisions in subsection 149.1(6.2).

In *A.B.L.E. Association*,[43] the Minister revoked registration and an appeal was launched. The Minister applied for an injunction pending the outcome of the appeal on the basis that the organization intended to solicit and accept chari-

table donations as a registered charity in an inappropriate manner. The Court granted the injunction, stating that irreparable harm would come to taxpayers making donations, to taxpayers generally and to legitimate charities who would be deprived of donations, through public loss of confidence if the injunction were not granted. The Court held that the Minister had acted reasonably in not revoking the registered status by a *Canada Gazette* notice under subsection 168(2), since the Minister had interpreted the appeal of the notice of revocation as a stay of further action, pending the outcome of the appeal. The Court found there was insufficient evidence to conclude that CCRA (then Revenue Canada) had acted sufficiently harshly, indifferently or egregiously to warrant refusing the injunction. The Court ordered that the injunction should issue but the injunction and its terms and conditions should remain confidential until the decision on the appeal of the decision to revoke was made public. It further held that granting the injunction did not render moot the ongoing appeal with respect to the revocation of registration.

The organization argued that the Minister should have proceeded (on the expiry of 30 days after notice had been published in the *Canada Gazette*), to revoke registration pursuant to subsection 168(2), in which event the organization would have been able to apply for judicial review of that decision in the Federal Court-Trial Division. The Court noted that the Minister was not required to treat the appeal of the notice of revocation as a stay of further action but having done so, this was a reasonable approach.

The Court rejected the argument that had notice of revocation been published, the charity could have applied for judicial review in the Federal Court-Trial Division. It was pointed out that under section 180, the jurisdiction of the Trial Division is ousted in matters governed by subsection 172(3), and the jurisdiction is vested exclusively in the Federal Court of Appeal.

Issuing Receipts

Since one of the main advantages of registration is the ability of a registered charity to issue official tax-credit receipts for gifts that it receives, the charity must comply with a number of requirements in the *ITA* and the regulations.

First and foremost, the charity must be satisfied that a "gift" has been made. It is beyond the scope of this article to deal extensively with the meaning of "gift", but in basic terms it generally means that there must be a gratuitous payment, without any "consideration" to any meaningful extent being received either directly or indirectly by the donor. It is not necessary that the "benefit" come directly from the charity. For instance, in some cases involving court proceedings, the "penalty" meted out by the court may involve a requirement that a "donation" be made to a charity. There is a serious concern that a payment made under duress is not a "gift" for this purpose, although the charity may have no knowledge of the circumstances in which the payment is being made.

In more obvious cases, where there is a direct link, such as the education provided at a private school, the situation is less clear. CCRA has developed guidelines based on jurisprudence, to deal with the portion of tuition that is deductible for payments made to religious schools.[44] However, there has been litigation dealing with the "link" between a donation made by a parent to a church and the education received by a child when the church used the funds to support an affiliated school.[45] [Rider XI]

Generally, a donor is not entitled to tax relief unless an official receipt is filed with the tax return, claiming the benefit of a tax deduction or a tax credit. In one case,[46] it has been held that a deduction was available without an official receipt as the gift was made in the form of a residual interest in an estate pursuant to a will and the property had not, in fact, been transferred to the charity. In a not unusual type of planning arrangement, the testator had provided in his will that the income from a trust would be paid to a surviving spouse for her lifetime and on her death the remaining capital would be paid to the charity. CCRA argued that it was impossible to value the gift at the date of death but the Court found that since there was no power to encroach, it was reasonable to use actuarial assumptions about mortality and a normal discount rate to arrive at the value of the property that the charity could expect to receive on the death of the spouse. More importantly, the Court was prepared to take a liberal approach to the requirement for a receipt, noting that in the circumstances of that case, Parliament could not have intended to deny a deduction simply because no receipt was available. This is an exception to the general rule.

The regulations provide that an official receipt must contain prescribed information including the name and address of the organization, the official registration number assigned by CCRA when registration is granted, the serial number of the receipt and the place where the receipt was issued, if the donation was made in cash, the day on which the donation was received, if the donation was made in property other than cash, the day on which the donation was received, a description of the property and the name and address of the appraiser if there is an appraisal, the day on which the receipt was issued where it is different from the day on which the gift was received, the name and address of the donor and, where the gift was made in cash, the amount of cash received and if the gift was a gift of property other than cash, the fair market value of the property at the time the gift was made. In addition, the receipt must contain a signature of a responsible official.[47]

The official receipt can bear a facsimile signature when all official receipts are distinctively imprinted with the name, address and registration number, are serially numbered by a printing press or a numbering machine, and unissued receipts are kept at a prescribed place until they are actually issued as official receipts.[48]

CCRA has developed guidelines for the use of technology by charities. It is now possible for donations to be made on line and for receipts to be issued on line through the internet, provided the requirements in the regulations are met. CCRA has indicated that its primary concern is that the issuance of receipts is controlled and the donor is not able to alter the amounts shown on the receipt or tamper with any of the other information show on it. There do not appear to be any hard and fast rules but charities that wish to issue electronic receipts would be well advised to communicate directly with CCRA in order to ensure that they are in full compliance. It seems that CCRA is mainly concerned that the electronic version of a receipt must have a signature in a digitized form, in the same way that documents and correspondence used generally in the commercial realm can now include a "signature" that is encrypted onto the document itself.

In some cases, intermediary organizations arrange for the donations, receiving the funds and passing them on as an agent for the charity and issuing receipts on behalf of the charity in exchange for a fee. It will be important that the process of issuing receipts be carefully monitored, particularly where the agent undertakes to issue the receipts on behalf of the charity and the "supply" of blank receipts may not be kept strictly in compliance with the requirements in the regulations. It is hoped that CCRA will continue to take an approach that is consistent with the practices in the modern marketplace.

Failure to comply with the requirements for issuing official receipts will subject a registered charity to revocation so the issuance of receipts must be very carefully monitored. The ability of registered charities to issue official receipts creates a major concern, from a tax policy perspective, that the tax incentive available to donors may be misdirected if the registered charity does not have appropriate charitable purposes or if receipts are being issued in "inappropriate" circumstances.

The issue of "receipting" had led directly to a number of court cases dealing with circumstances in which CCRA has challenged whether a gift was, in fact, made or whether the gift was made for the amount claimed by the taxpayer. It is important that registered charities have a system in place to deal with the valuation of gifts of property in kind and that they be aware of the consequences of entering into any type of fundraising arrangement that is out of the ordinary,

Compliance

Registered charities must take compliance issues seriously. Failure to file the annual T3010 form subjects the charity to revocation proceedings. The annual form is the means by which CCRA attempts to determine whether a registered charity is fulfilling its charitable mandate. After the charity has been registered, CCRA has little opportunity to monitor its activities, aside from investigating complaints that may be received from members of the public, and the prescribed information that must be filed under the *ITA* and the regulations, the main ways in which it monitors the activities of registered charities. (Form T3010 has undergone changes in recent years and now requires disclosure of an extensive amount of information.)

CCRA has stated that it selects registered charities for audit for several reasons. These could include a random selection, a review of compliance with specific legal obligations under the *ITA*, or a follow-up on possible noncompliance or complaints and the need for confirmation that assets have been distributed after a revocation. Where a charity is selected for audit, CCRA will contact it in advance to arrange a mutually convenient time to begin the audit and the charity will be advised of the results. CCRA has outlined its audit procedures in T4118, *Auditing Charities*.

Other Tax Legislation

There are a number of other statutes, both provincial and federal that are frequently relevant to a registered charity. This article will not examine them in detail but a few are of particular interest.

(a) *Excise Tax Act*

The *Excise Tax Act* is the legislation that imposes the GST (Goods and Services Tax). It can apply to registered charities that make taxable supplies and are required to collect the GST and to registered charities that receive taxable supplies and are required to pay the GST. There are certain exceptions for transactions involving donations and fundraising events. In some cases, if there is a level of publicly funded support through government grants, a charity may be entitled to a rebate rather than an input tax credit. In general terms, an input tax credit is available where GST has been paid to a supplier in the course of a commercial activity carried on by the charity. Frequently, charities do not make taxable supplies but are required to pay GST on the supplies they receive. If they are not entitled to claim input tax credits, this rebate mechanism provides them with a partial, but not complete, recovery of their GST costs.

There is no blanket exemption from GST merely because an organization is a registered charity under the *ITA*. In each case, the charity should review its situation carefully, to determine whether it is entitled to provide relief to third parties for whom it makes supplies, particularly in the course of fundraising. There are specific definitions for GST purposes and it should not be assumed

that the concepts and definitions used for purposes of the *ITA* are necessarily consistent for purposes of the GST.

CCRA has published a number of helpful guides and bulletins, which are available on its web site. In particular, RC 4082, *GST/HST Information for Charities*, is a useful reference.

(b) *Retail Sales Tax Act*

In Ontario, the provincial retail sales tax (PST) is generally payable on the purchase of certain types of tangible personal property.[49] With a few exceptions, it does not apply to real estate or to intangible property. In some cases, it can also apply to taxable services. As in the case of the GST, there is no blanket exemption from PST merely because an organization is a registered charity. It will be necessary to review each transaction to determine whether the purchase of tangible personal property by the charity is subject to tax and whether the supplying of tangible property requires the charity to collect PST.

Registered charities should be aware that they are required to collect PST on the price of admission to events, unless there is an exemption. They are also required to pay PST on purchases of property, unless an exemption is available.

In some cases, registered charities may combine with commercial enterprises to "sponsor" events, so that PST is not payable on the admission price. Ontario is taking steps to try to prevent abuses that apparently have occurred as a result of the inappropriate "rental" of the name of a charity by a commercial organization. Charities that intend to participate in this type of fundraising by sponsoring events should realize that they may incur a real business risk by offering the advantage of an exemption from PST on the price of admission to the event.

There are rules dealing with "promotional distributions", which in some cases impose PST on the supplier rather than the person receiving the supply. Charities should be aware that PST implications can be a factor in their day-to-day operations, depending on the nature of their charitable activities. Ontario has special incentives for gifts of certain types of property to registered charities that are education institutions. In the 2000 Budget, it announced that since donations to educational institutions might otherwise be subject to tax as promotional distributions, it intended to change the rules to ensure that donations made to qualifying Ontario educational institutions would be exempt from PST and the person making the gift would not be subject to PST on the basis that a promotional distribution has been made.

As in the case of the GST rules, charities should be aware of their responsibilities under the PST legislation and, where necessary, should obtain a permit to collect PST on taxable sales of tangible personal property and supplies of taxable services to retail purchasers.

In some cases, a registered charity may be formed by special statute and may be entitled to special tax exemptions, over and above those set out in a taxing statute. For instance, certain public hospitals and larger universities or arts organizations are formed by special statute. In one case, the Ontario Cancer Institute, carrying on business as the Princess Margaret Hospital and Sunnybrook Hospital (as it was then known) were held to be exempt from PST by virtue of the special provisions in their statutes.

Before the Toronto General Hospital (TGH) and Toronto Western Hospital (TWH) amalgamated, they had each been exempt from tax under their specific statutes. In the course of the amalgamation, it appears that the tax exemption was not carried forward in the amalgamating statute. The court found that the amalgamation resulted in a continuation of each of the predecessor entities and therefore it must have been intended, although the amalgamating statute did not expressly so provide, that the tax exemptions were to carry through the amalgamation and be available to the merged entity.

The Ontario tax authorities argued that since another amalgamation involving other Ontario hospitals, had been carried out by a statute that *did* contain an explicit tax relieving provision, it should be concluded that the absence of that provision in the TGH/TWH case was decisive. The court rejected that argument, finding it was unreasonable to infer that the failure to include the tax exemption in the statute signified an intention by the legislature to withdraw the exemption from Toronto's major hospitals when it was clear that the same benefits were available to the other large hospitals which had amalgamated and had been given an exempt status in their amalgamating statute. The judge obviously wanted to reach the "correct" conclusion, based on public policy considerations, rather than necessarily applying the letter of the law. However, on appeal the Ontario Court of Appeal reversed the decision on the basis that the earlier statutes were repealed and the exemptions were discontinued.[50]

(c) *Assessment Act*

Under the *Assessment Act*[51], tax is generally payable in Ontario by the owner of land, based on the value of the land. There are some exceptions for situations involving registered charities. For instance, public hospitals may be exempt. In addition, certain other public bodies and philanthropic organizations may be exempt. There is no blanket exemption merely because an organization is a registered charity under the *ITA*. In each case, it will be worthwhile for the organization to review its property tax situation carefully because this is an annual cost based on the assessed value of the property.

Under section 3 of the *Assessment Act*, there are exemptions for the following:

(i) a place of worship and the land used in connection with it;

(ii) land owned, used and occupied solely by a university, college, community college or school as defined in the *Education Act* or land

leased and occupied by any of them, if the land would be exempt from taxation if it was occupied by the owner;

(iii) land owned, used and occupied solely by a nonprofit philanthropic religious or education seminary of learning or land leased and occupied by any of them if the land would be exempt from taxation if it was occupied by the owner, but excluding land with an area of more than 50 acres;

(iv) land used and occupied by a public hospital that receives provincial aid under the *Public Hospitals Act*, but not any portion of the land occupied by a tenant of the hospital;

(v) property owned, occupied and used solely and only by the Boy Scouts Association or the Canadian Girl Guides Association or by any provincial or local association or other local group in Ontario that is a member of either association or is otherwise chartered or officially recognized by it;

(vi) land owned, used and occupied by a nonprofit philanthropic corporation for the purpose of a house of refuge, the reformation of offenders, the care of children or similar purpose but excluding land used for the purpose of a daycare centre;

(vii) land owned, used and occupied by any charitable, nonprofit philanthropic corporation for the relief of the poor if the corporation is supported in part by public funds;

(viii) the property of a Children's Aid Society discharging the functions of a Children's Aid Society under the *Child and Family Services Act* if used exclusively for the purposes of, and in connection with, the Society.

Many of these exemptions have been the subject of litigation, particularly those involving claims based on homes for the aged and seminaries of learning.

It will be important in each case to review the basis for exemption very carefully. In many cases, the exemption turns on the ownership of land and not on its occupation. Many registered charities are subject to tax notwithstanding the worthy causes that they foster.

The Province has indicated a willingness to provide relief to registered charities, without providing a blanket exemption for them. In a particular situation, a charity should obtain specific advice about its property tax situation. If an exemption is not available, the charity should consider whether some relief is available.

(d) *Land Transfer Tax Act*

A registered charity is not exempt from paying land transfer tax in Ontario when it purchases real estate but when a registered charity is formed by special legislation, there may be a specific exemption from land transfer tax. In the absence of this type of special relief, registered charities will generally be required to pay tax when they purchase land but, if they receive a gift of land, as long as there is no mortgage or other encumbrance on it and therefore no "consideration" paid to the "donor" through the assumption of the liability by the charity, there should be no land transfer tax.[52]

As in the case of the other statutes, it will be important that a charity consider the tax consequences of the purchase of land since there may be an additional cost in the form of land transfer tax if no exemption is available.

(e) *Provincial Income Tax*

Ontario imposes a separate income tax on both individuals and corporations but in each case the exemptions available to a registered charity under the *ITA* are carried through into the Ontario legislation. As a result, if a charity is registered under the *ITA*, Ontario will recognize the exemption, whether the charity is a corporation, an association or a trust. Where a corporation makes a donation that is eligible for a tax deduction under the *ITA*, Ontario will provide the same treatment in computing Ontario tax. In the past in Ontario, personal income tax has been determined as a percentage of the federal tax. As a result, deductions in computing tax as a result of credits for donations recognized under the *ITA* automatically provided relief for provincial income tax purposes. Ontario has implemented its own individual income tax system but donations that are recognized for purposes of the *ITA* will also be recognized for purposes of the Ontario rules.

Conclusion

I have tried to provide an overview and not an exhaustive analysis of various issues that will be relevant in advising charitable organizations on becoming registered and maintaining registered status. Each case will be different but determining whether the purposes are "charitable" and whether the proposed activities are acceptable will always be the starting point. Unfortunately, in difficult cases, CCRA holds all of the cards in determining whether to grant registration so the process for registration can be very frustrating. I hope this article alleviates some of the mystery and frustration and will help advisers to keep their charitable clients on track after they are registered.

FOOTNOTES

1. RSC 1985, c.1 (5th Supp.), as amended (hereinafter referred to as the *ITA*). Unless otherwise stated, statutory references in this paper are to the *ITA*.
2. It is beyond the scope of this article to deal with the exemptions in the *ITA* for other organizations, such as paragraph 149(1), dealing with "not-for-profit" organizations,

paragraph 149(1)(k), dealing with fraternal benefit societies and labour organizations, and similar exempting provisions.

3 There are specific exemptions for corporations that are controlled by the Crown or by a municipality. See paragraphs 149(1)(d)–(d.6) and subsections 149(1.1) to (1.3) and proposed subsection 149(1.11).

4. Paragraph 149(1)(f). The exemption is based on a period of time throughout which the person has the status of a registered charity.

5. Subsection 227(14), which provides that Parts IV, IV.1, VI and VI.1 do not apply to any corporation for any period throughout which it is exempt from tax under section 149.

6. Paragraph 181.1(3)(c).

7. Subsection 248(1).

8. Sections 118.1 and 110.1, respectively.

9. *L.I.U.N.A. Local 527 Members' Training Trust Fund* v. *The Queen*, 92 DTC 2365 (TCC).

10. Of his own volition, the judge also raised another issue dealing with the validity of the trust under provincial law and whether it was void as contravening perpetuities legislation. Notwithstanding the fact that both counsel agreed on this point, the judge took it upon himself to canvass the issue, finally concluding that the perpetuities legislation in Ontario "saved" the trust as a "purpose" trust rather than a trust with typical "beneficiaries".

11. Subparagraph 38(a.1)(i). See also the rules dealing with "non-qualifying securities" and "excepted gifts" in section 118.1.

12. Subsection 149.1(6). There are situations in which it is advantageous for charities to be associated if they move funds between them. See Information Circular 77-6 *Registered Charities: Designation as Associated Charities.*

13. Subsection 149.1(6.2). See the discussion later in this article on political activity.

14. Subsection 149.1(10).

15. See subsection 149.1(1) and the definition which states that in relation to a charity, "related business" includes a business that is unrelated to the objects of the charity if substantially all persons employed by the charity in the carrying on of that business are not remunerated for their employment. For a discussion of "related business" see *Alberta Institute on Mental Retardation* v. *The Queen*, 87 DTC 5306 (FCA). [See Rider II]

16. Subsection 149.1(1).

17. Section 149.1(1), definition of "charitable purposes".

18. CCRA takes a very expansive view of the meaning of "non-arm's length". See the comments in RC 4108 and the examples cited by CCRA which include employees in situations that most legal advisers would consider clearly to be arm's length arrangements. CCRA has expressed the view that where a charity is formed with "incorporators" who are working in the same office but otherwise unrelated, it will automatically be "private", notwithstanding that the funding is obtained from diverse sources and the "permanent" board will shortly consist of individuals dealing at arm's length.

19. CCRA has said that issuing a charitable gift annuity as a means of fundraising is not permissible for a charitable foundation since it results in debt. On the other hand, since this restriction does not apply to a charitable organization, CCRA has generally confirmed that the issuing of charitable gift annuities is acceptable for them. Other issues can arise

depending on the degree of activity involved and whether the activity constitutes a "business".

20. Subsection 149.1(13).
21. See RC 4108 and Information Circular 77-6.
22. For a detailed discussion of the CCRA requirements imposed on the foreign activities of Canadian charities, see David J. Amy, "Foreign Activities By Canadian Charities" (2000), 15 *Philanthrop.* No.3, pp. 41–69.
23. James Travers, "Charity law has far-reaching consequences", *The Toronto Star*, Saturday, February 24, 2001, p. K2.
24. *Commissioners for Special Purposes of the Income Tax Act* v. *Pemsel* (1891), A.C. 531 (H.L.)
25. 43 Eliz.1, c.4, enacted in 1601 and generally referred to as the *Statute of Elizabeth.*
26. *Vancouver Society of Immigrant and Visible Minority Women* v. *MNR*, [1999] 1 S.C.R. 10.
27. *Vancouver Regional FreeNet Association* v. *MNR*, 96 DTC 6440 (FCA).
28. *Re Laidlaw Foundation*, 19 E.T.R. 77 (Ontario Supreme Court-Divisional Court).
29. The current version of the statute is the *Charities Accounting Act*, R.S.O. 1990, c. C.10. See section 7, which defines "charitable purposes".
30. See footnote 29, *supra*. See also the *Charitable Gifts Act*, R.S.O. 1990, c. C.8, which limits the ability of a charity to own an interest in a business.
31. For an interesting discussion of the federal regulation of charities and an analysis of various proposals for reform, see Patrick Monaghan and Elie Roth, "Federal Regulation of Charities" (2000), 15 *Philanthrop.* No.4, pp. 29–54. The Voluntary Sector Task Force web site at www.pco-bcp.qc.ca contains more detailed information about the federal government's initiatives.
32. For a discussion of these issues, see Arthur B.C. Drache and W. Laird Hunter, "A Canadian Charitable Tribunal: A Proposal for Implementation" (2000), 15 *Philanthrop.* No.4, pp. 30–28 (Part I) and 16 *Philanthrop.* No.1, pp. 4–27 (Part II). See also the article by Monaghan and Roth, footnote 31, *supra.* [See Rider VII]
33. The CCP has a web site at www.ccp.ca, which contains a wealth of information. See also the web site for The Muttart Foundation at www.muttart.org. The Muttart Foundation retained the CCP to conduct an extensive survey, the results of which are available on the web site. [See also "The Legal Definition of Charity and Canada Customs and Revenue Agency's Charitable Registration Process" (2002), 17 *Philanthrop*. No. 3, pp. 3–56.]
34. "Application for Registration: A Revenue Canada Taxation Perspective" (1986), 6 *Philanthrop.* No.3, pp. 2–10.
35. Section 188. CCRA does not apply the penalty to a qualified donee that receives property from a de-registered charity.
36. Section 189.
37. *Supra*, footnote 35.
38. Sections 207.3 and 207.31. For a discussion of the regime dealing with cultural property, see *Aikman* v. *The Queen*, 2000 DTC 1874 (TCC). CCRA has set out much of the

information relating to gifts of cultural property in IT-407R4, *Dispositions of Cultural Property to Designated Canadian Institutions.*

39. If the shares are common shares, the corporation would generally be entitled to deduct the dividends in computing its taxable income under section 112.
40. Section 163.2.
41. One planning technique was based on the definition of "listed personal property" and the fact that there is a deemed $1,000 cost for certain types of capital property. If a property is purchased for less than $1,000, its deemed cost will be $1,000. This led to the development of various "gifting" programs (frequently involving works of art), that were perceived to be abusive by CCRA. In the 2000 Federal Budget, the Department of Finance proposed changes to eliminate this type of planning where property is acquired "as part of an arrangement under which the property is gifted to a qualified donee".
42. *Alliance for Life* v. *The Queen*, 99 DTC 5228 (FCA).
43. *A.B.L.E. Association for the Betterment of Literacy and Education* v. *The Queen*, 98 DTC 6668 (FCA).
44. Information Circular 75-23, *Tuition Fees and Charitable Donations Paid to Privately Supported Secular and Religious Schools.*
45. *Woolner* v. *The Queen*, 99 DTC 5722 (FCA).
46. *Estate of Jeffrey O'Brien* v. *MNR*, 91 DTC 1349 (TCC).
47. Regulation 3501(1). The regulations will be amended to deal with split receipting for gifts received after December 20, 2002.
48. Regulation 3501(3.1).
49. *Retail Sales Tax Act*, R.S.O. 1990, c. R.31.
50. *University Health Network* v. *Ontario*, [2002] Ont. 00-032 (OCA). (The combined hospitals changed their names to University Health Network after the merger.)
51. R.S.O. 1990, c. A.31.
52. CCRA has indicated that, for purposes of the *ITA*, there may be a problem where real property subject to a mortgage is donated to a registered charity. The assumption of the mortgage may constitute unacceptable "consideration" flowing from the charity to the donor, thereby tainting the "gift" for purposes of the *ITA.* CCRA addresses this in a newsletter dealing with the December 2002 Amendments and Split-Receipting.

Author's Revisions and Additions

IThe body of the article therefore does not necessarily reflect subsequent changes in legislation, jurisprudence or administrative practice. The Department of Finance announced changes to the *ITA* on December 20, 2002, that will, among other things, affect the concept of "gift" at common law and introduce a concept of "split receipting". These changes will also deal with the categorization of a registered charity as a charitable organization, a public foundation or a private foundation and will introduce a more restrictive concept of "control" in determining whether an organization is a private foundation. This will also prevent a

registered charity from making a gift to a person other than a qualified donee, unless the gift is made in the course of the charity's charitable activities. In addition, the courts have dealt with the concept of "related businesses" and CCRA has introduced a policy paper dealing with the concept of "related business". The courts have also dealt with agency relationships and the requirements that must be met by a registered charity that uses the facilities of a nonresident organization to carry out its charitable activities abroad. These recent developments are discussed in various footnotes or added at appropriate places, to supplement the original version of the article; however, the article is not meant to be a discussion of the current law.

II In *Earth Fund* v. *MNR*, 2003 DTC 5016 (FCA), a corporation operated an internet lottery, the proceeds of which were to be given to qualified donees. The Court treated this as a business that was not related and refused registration and distinguished *Alberta Institute*, on which the corporation had relied. In addition, CCRA released a policy paper entitled "What is a Related Business?" on March 31, 2003, containing an extensive analysis of its approach to the concept of "related business".

III In *The Canadian Committee For the Tel Aviv Foundation* v. *The Queen*, 2002 DTC 6843 (FCA), the organization had its registration revoked for a number of reasons, including failure to keep a separate bank account and lack of direction and control over funds that were spent by a foreign agent. In *Canadian Magen David Adom for Israel* v. *The Queen*, 2002 DTC 7353 (FCA), CCRA took steps to deregister the organization for, among other things, not adhering to CCRA's administrative policy dealing with "charitable goods". Ambulances and other equipment unconditionally given to a foreign charitable organization were not considered to have been used directly by the charity in carrying out its charitable activities. It is understood that leave to appeal to the Supreme Court of Canada was sought and a satisfactory arrangement was subsequently reached between the organization and CCRA.

IV The anti-terrorism measures enacted in Bill C-36, which, among other things, amended the *ITA* provisions dealing with registration and revocation of registration. These rules were set out in part 6, which established the *Charities Registration (Security Information) Act.* For an overview, see *Registered Charities News Letter*, Spring 2002–No. 12.

V CCRA has released a new concept draft entitled *Registered Charities – Political Activities* which is available on its web site.

VI Since this article was originally written, CCRA's performance has improved dramatically. This is a direct result of the influence of Maureen Kidd, the Director General of the Charities Directorate, who has raised

the level of performance at the Charities Directorate and who should be highly commended for doing so.

VII The federal government has led an initiative taken by the Voluntary Sector Initiative (VSI), including the Joint Regulatory Tables (JRT). The JRT released its report and 75 recommendations on a variety of topics in March, 2003. The report is available on the VSI web site at www.vsi-isbc.ca/index.cfm.

VIII To its considerable credit, and again thanks to Maureen Kidd, CCRA has taken a number of useful initiatives. There is now a list of newly registered charities and a list of de-registered charities on its web site. In addition, form T3010 is now available on the web site. For an outline of CCRA's mission statement and "future directions", see RC4313, *Future Directions For the Canada Customs and Revenue Agency – Charities*, dated November 15, 2002.

IX Apparently in response to this test case, the Department of Finance announced in the December 20, 2002 amendments that a registered charity is liable to have its registration revoked if it makes a gift to any person who is not a qualified donee in any circumstances, unless that gift is made in the course of carrying out its charitable activities. As a result, unless the agency concept is used, even where the disbursement quota has been met, it will not be permissible for a registered charity to transfer funds to an unregistered charity, either in Canada or outside Canada.

X The appeal procedure and the procedures for revocation generally have been amended as a result of Bill C-36 implementing various anti-terrorism measures.

XI The proposal introduced on December 20, 2002 will, among other things, attempt to "save" a gift that would fail at common law because the "donor" receives an advantage or benefit from the recipient. It is not clear that the proposed amendments will be effective. Despite suggestions that the concept should be revised to deem a gift to have taken place, the Department of Finance plans to proceed with the original proposal. This is intended to legitimize the administrative practice of "split receipting" which CCRA has adopted for many years.