The How, Why, and When of Using Multiple Corporate[1] Structures

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Introduction

The charitable sector in Canada today faces increasing demands for efficiency and effectiveness owing to shrinking government contributions, the advance of technology and, in large part, the constant establishment of new charities and the resulting intense competition for donor dollars. Additionally, the loss of public trust in the for-profit sector has spilled over into the voluntary sector, and charities are expected to account to their donors, members, and the public as never before. At the same time, charities operate in a fragmented, fairly archaic, and unyielding legal framework, which presents a host of restrictions on their abilities to effectively raise funds and protect their assets to ensure longevity. Charities must, therefore, employ innovative strategies to survive and ultimately succeed in the years ahead.

In certain circumstances, charities may wish to make use of different corporate or other vehicles to maximize their ability to operate efficiently and effectively while protecting their assets and minimizing their exposure to liability. Part I of this article outlines a variety of reasons why charities may wish to consider using different vehicles. Part II presents the main vehicles that may be used in the charity context and the risks and/or pitfalls associated with them.

Part I: Why Different Vehicles?

The current legal framework in which charities operate creates substantial obstacles for charities that are raising funds and trying to successfully accomplish their objectives. Charities are restricted in their ability to develop and benefit from commercial opportunities and engage in political activity. In addition, charities operating in Ontario cannot hold land for investment or income purposes. Furthermore, charities may wish to compartmentalize their fundraising operations or program deliveries. Different vehicles can provide opportunities for charities to do so while protecting their assets and minimizing their exposure to liability.

Restrictions on Carrying on Business

Charities are restricted in their ability to develop and benefit from commercial opportunities and, thus, raise funds in innovative ways. The *Income Tax Act* prohibits charitable organizations and public foundations from carrying on an unrelated business and prohibits private foundations from carrying on any busi-

ness.[2] If they do so, their charitable registration could be revoked and they could be subject to significant sanctions.[3] In addition, a director of a charitable organization or public foundation that carries on an "unrelated business" (or a director of a private foundation that carries on any business) may be exposed to personal liability, given directors' trustee-like obligations in the context of charities.[4] For example, if a charity loses its charitable registration because it carried on an unrelated business, the directors of the charity could potentially be held responsible if it is determined that the directors did not act reasonably and prudently in directing the charity to carry on the business activity.

Subsection 149.1(1) of the *Income Tax Act* provides that a "related business" includes a business unrelated to the objects of a charity if "substantially all" the employees in the business are unpaid.[5] Since subsection 149.1(1) does not contain an exhaustive definition of a "related business," the extent of what else constitutes a "related business" is unclear. Attempts have been made in several cases to clarify the law,[6] but decisions have been made on narrow grounds, thereby providing no clear direction to charities. The Canada Revenue Agency ("CRA") has published a Policy Statement that contains an extensive discussion of what constitutes a related business.[7] This Policy Statement specifies that, "[i]n general terms, a business involves commercial activity—deriving revenues from providing goods or services—undertaken with the intention to earn profit."[8] The Policy Statement further stipulates that whether a business is related to a charity's objects will depend on the facts of each case considering several factors set out by the courts.[9] The Policy Statement also provides a decision tree analysis for determining whether a business is an unrelated business. However, despite these guidelines, it is still not always clear what constitutes a "related" business activity.

Given the uncertainty surrounding the concept of related business, charities may wish to consider creating alternative vehicles to carry on business activities that are not clearly related, or that are unrelated, in order to benefit from such activities.

Restrictions on Holding Land

Subsection 8(1) of the *Charities Accounting Act*[10] prohibits a person who holds land for a charitable purpose from holding land other than for actual use or occupation for the charitable purpose. Subsection 8(2) of that Act provides that the Public Guardian and Trustee (the "PGT")[11] may seize land held for a charitable purpose which has not been used or occupied for the charitable purpose for three years, is not needed for the actual use or occupation for the charitable purpose, and will not, in the immediate future, be needed for the actual use or occupation for the charitable purpose. Charities hold their property for their charitable purposes. Therefore, they are subject to this restriction and may not hold land for long-term future use or for investment or income purposes and could lose the land if they do so.

While the *Charities Accounting Act* applies to charities incorporated, and charitable trusts established, in Ontario (whether or not they are registered charities under the *Income Tax Act*), the application of the Act to other charities is less clear. According to submissions made by the Public Trustee for Ontario (as it was then known) to the Ontario Law Reform Commission, the PGT claimed jurisdiction over charitable corporations that carry on their activities in Ontario whether or not they are incorporated in Ontario.[12] It is the author's understanding that the current position of the PGT is that the *Charities Accounting Act* applies to, and the PGT has authority over, extra-provincial charitable corporations that have their head office or principal place of operations in Ontario or that operate in Ontario. Whether or not the PGT has such authority is a subject for another article.

In addition, it is unclear whether a charity subject to the *Charities Accounting Act* (particularly a charity that is incorporated or established outside of Ontario but that operates in Ontario) is restricted by that *Act* from holding land in other jurisdictions other than for its own use or occupation since the *Charities Accounting Act* does not specify land held "in Ontario." It is the author's understanding that the PGT has not established a position at this time but that the PGT would not want to limit its authority since the rationale for the provision in the *Charities Accounting Act* is that a charity's assets should not be tied up in land.

Some charities may have other options for holding land.

Restrictions on Political Activities

The *Income Tax Act* stipulates that where a public or private foundation devotes substantially all of its resources to charitable purposes or where a charitable organization devotes substantially all of its resources to charitable activities carried on by it, if the charity devotes part of its resources to political activities, the charity will be considered to be devoting its resources to charitable purposes or charitable activities carried on by it, as applicable, provided that the political activities are ancillary or incidental to its charitable purposes or activities, and provided that such activities do not involve the direct or indirect support of or opposition to any political party or candidate for office.[13] "Substantially all," according to CRA, means 90% or more.[14] Therefore, a charity cannot devote more than 10% of its resources (including financial and human) to political activities.

Historically, CRA took a much more restrictive approach to charities carrying on political activities. Notwithstanding that a charity can now carry on some political activities, the types of political activities that charities may become involved in, and the positions they may take, are still restricted. According to CRA's Policy Statement "Political Activities":[15]

> In order to serve the public, the information charities give on public policy issues should be presented in an informative, accurate, and well-reasoned way to enable society to decide for itself what position to take.

> In addition, when charities choose to contribute to public policy debates, they are required by law to do so in a way that considers certain constraints. A charity cannot be established with the aim of furthering or opposing the interests of a political party, elected representative, or candidate for public office. Also, a charity cannot be formed to retain, oppose, or change the law, policy, or decision of any level of government in Canada or a foreign country. However, charities may choose to advance their charitable purposes by taking part in political activities if they are connected and subordinate to those purposes.

In order to fulfill some or all of their purposes, it is critical for many charities to pursue political activities. The limits on the types of political activities that charities may take and the limit on the resources that charities may devote to political activities can severely hamper a charity's ability to attain its objectives.

Accordingly, to avoid engaging in any prohibited political activities and to maximize a charity's ability to, in effect, advance its objectives through political activities, it may be beneficial for a registered charity to use other vehicles to accomplish its goals.

Fundraising

Fundraising is a significant issue for charities today. There are numerous reasons why a charity may wish to consider creating a separate vehicle for fundraising purposes. In an effort to raise their profile, charities strive to recruit high-profile directors to sit on their boards. However, many people are reluctant to act as directors because they do not want the exposure to liability, especially on boards of organizations that carry on high-risk activities. People may be more willing to sit on the board of a sister charity that only fundraises.

In addition, much time is spent at a charity's board meetings discussing fundraising rather than operational issues. Creating a sister charity for fundraising may alleviate this problem.

Furthermore, it may be beneficial for a national or provincial charity to set up local charities for fundraising purposes as donors may feel more of a connection to their local charity than to a charity that serves a broader contingency.

Protection of Assets and Minimization of Exposure to Liability

Many charities operate within the context of a larger group. For example, a charity may be a national organization that has provincial divisions, which themselves have local divisions. The incorporation of each division (national, provincial, and local) may protect the assets of one division from the liabilities of the others.

Some charities have accumulated substantial assets or wish to raise significant funds. However, they wish to protect these assets and funds from exposure to liability, particularly where they carry on higher risk activities, such as providing services to vulnerable people like children and seniors. Holding these funds in a different entity may provide such protection. In addition, if a charity raises

significant funds to ensure the longevity of the charity, the directors may wish to protect those funds from subsequent boards who may not be as concerned about the future.

It may also be beneficial for some charities if their accumulated funds do not appear on their balance sheets because those funds could affect their ability to obtain additional funds from government and other sources. Furthermore, future government grants may be cut back if a charity is seen to be flush with cash, or the funds may be viewed as being excess grant funds and the grantor may request that they be repaid.

Funds held by a sister charity may provide a solution to these dilemmas.

Part II: Different Types of Vehicles

There are different vehicles though which charities can operate to achieve various objectives. The type of vehicle best suited to a charity will depend upon what the charity is trying to achieve. The following is a description of some of the different vehicles, the purposes of each vehicle, and the benefits and risks associated with using them.

Share Capital Corporations

A charity may set up a separate, share capital corporation to carry on business outside of the charity's own organizational structures. The creation of a share capital corporation will generally be undertaken where a charity wishes to commence a business activity that is clearly not a related business of the charity or where the issue is murky and the charity does not wish to take a risk. A charity may choose a share capital corporation over another form of entity since it is a familiar vehicle in the business world and so as not to be perceived as unfairly competing with other businesses, thereby avoiding poor public perception.

A share capital corporation owned by a charity that carries on an ordinary commercial enterprise is a taxable corporation subject to the applicable tax rules in the *Income Tax Act*. A share capital corporation may distribute up to 75% of its income to a charity as a charitable donation.[16] However, if a charity receives a donation from a share capital corporation and issues a donation receipt for such donation, the donation will fall into the charity's 80% disbursement quota requirement.[17] On the other hand, a corporation may declare dividends to its charity shareholder out of its after-tax income. As a tax-exempt entity, the charity will not pay tax on the dividends received and the income will not fall within the charity's 80% disbursement quota obligation.[18] The shares of the share capital corporation owned by the charity will, however, be treated as assets of the charity for the purposes of calculating the charity's obligation to disburse 3.5% of its investment income.[19]

One of the limitations that charities operating in Ontario face in attempting to use business corporations is found in section 2 of the *Charitable Gifts Act*.[20] In Ontario, a charity (other than a religious denomination) may not own more than

a ten percent interest in a business that is carried on for gain or profit. According to subsection 2(4) of the *Charitable Gifts Act,* a charity shall be deemed to have an interest in a business:

(a) if [it] is a part owner of a business;

(b) if [it] holds or controls, directly or indirectly through a combination or series of two or more persons, one or more shares in a corporation that owns or controls or partly owns or controls the business; or

(c) if [it] holds or controls, directly or indirectly through a combination or series of two or more persons, one or more bonds, debentures, mortgages or other securities upon any asset of a business.

Where ten percent ownership is exceeded, there is a requirement to divest within seven years.[21] Application may be made to the Ontario Court (General Division) (now the Superior Court of Justice) for an extension. An extension will be granted if the court believes that it will benefit the "religious, educational, charitable or public purpose concerned."[22]

Although a charity may consider using a share capital corporation to carry on a short-term business activity, the *Charitable Gifts Act* imposes further obligations where a charity's interest in a business is greater than 50 percent. In such cases, the PGT is given a say in determining the profits earned by the business each year and the charity has reporting obligations to the PGT.[23]

In addition, the *Charitable Gifts Act* contains a penalty provision that could impose a fine of up to $10,000 and/or imprisonment of up to one year upon a charity and its legal representatives (that is, its directors and officers) who contravene the Act.[24]

While the use of a share capital corporation which is owned directly by a charity operating in Ontario should be approached with caution, a share capital corporation can be used in conjunction with other vehicles, as discussed below.

Business Trusts

More and more, charities are utilizing business trusts to obtain the benefits of a business activity. In some cases, it is unclear whether the business activity would be a related business of the charity and in other cases the activity is clearly not a related business. Accordingly, charities are looking for alternative ways to pursue commercial opportunities without risking their status as registered charities. One vehicle that is being used in these circumstances is the business trust.

A trust is established by an agreement between the person who creates the trust (called the settlor) and the person (called the trustee) obligated to deal with the property held by the trust (called the trust property) for the benefit of some person (called the beneficiary).[25] The settlor, the trustee, and the beneficiary can be the same person.[26] The charity could sell to the business trust an asset that it wants to commercialize (such as intellectual property) that has a nominal value at

the time of sale, or the trust could subscribe for shares of a corporation that will operate a business activity. (A charity cannot simply transfer an asset to a business trust since charities may only transfer their assets to qualified donees[27] and the trust would not be a qualified donee.[28]) The proceeds of the commercialization of the asset or the profit from the business activity would go to the trust. The trust would distribute such proceeds or profits to the charity.

Although a trust is not a legal entity at law, the *Income Tax Act* considers a trust to be a taxable entity and it is taxed as an individual,[29] generally at the top marginal rate. However, a trust can deduct from its taxable income for a year distributions made to the beneficiaries of the trust (that is, the charity) prior to year-end.[30] Since the beneficiary of the trust would be a non-taxable entity (that is, the charity), the distribution by the trust results in no tax at the trust level (so long as all income is distributed before year-end) and no tax at the beneficiary level.

Since a charity is a tax-exempt entity, it will not pay tax on the distributions that it receives from the trust and the distributions will not fall within the charity's 80% disbursement quota obligations. However, the charity's interest in the trust may need to be included in the investment income of the charity for purposes of calculating its 3.5% disbursement quota obligation.[31]

There are evident advantages to a charity using a business trust. Clearly, since no tax is paid on the profits realized by the trust that are distributed to the charity, there would be greater financial gain to charitable beneficiaries. Moreover, operating through a trust may permit a charity to avoid the limitations it encounters with respect to carrying on an unrelated business under the *Income Tax Act* and with respect to owning an "interest in a business" under Ontario's *Charitable Gifts Act* (provided, in the latter case, that the charity does not indirectly control the share capital corporation owned by the trust).

There are several pitfalls and risks associated with using business trusts, the most significant of which is that the assets of a trust are subject to a deemed disposition for tax purposes every 21 years,[32] which might trigger capital gains. One way of dealing with this problem is to have a second beneficiary, such as a nonprofit corporation that is controlled by the charity. The trustees of the trust could distribute the business or the shares to the alternative beneficiary before the deemed disposition date. After this distribution, another trust structure could be set up to minimize the risk of the alternative beneficiary to liabilities arising from the business and so that the alternative beneficiary would not be offside the *Charitable Gifts Act*. (See the discussion below regarding the application of this statute to nonprofit organizations.)

Another pitfall is that all income of a trust must be distributed to the beneficiary charity by the end of each fiscal year in order to avoid tax at the trust level. Furthermore, the trustees of a trust will be personally liable for the actions and activities of the trust since the trust is not a separate legal entity. As such, it would

be prudent for there to be a corporate trustee of the trust, either a share capital corporation or a nonprofit corporation.

One additional consideration is that the business world is not as familiar and perhaps comfortable with trusts carrying on business. Therefore, a charity should consider the marketplace in which the trust will be operating to ensure that it can do so effectively.

Unincorporated Religious Organizations

Charities established for religious purposes in Ontario may wish to consider not incorporating or incorporating and operating in tandem with an unincorporated organization in order to avoid the limitations of the *Charities Accounting Act* regarding holding land and to take advantage of the benefits offered by the *Religious Organizations' Lands Act*[33] ("ROLA"). Subsection 10(1) of ROLA permits a religious organization to lease land that it no longer requires for up to forty years. Under ROLA, a religious organization is defined as follows:

> "religious organization" means an association of persons,
>
> (a) that is charitable according to the law of Ontario,
>
> (b) that is organized for the advancement of religion and for the conduct of religious worship, services or rites, and
>
> (c) that is permanently established both as to the continuity of its existence and as to its religious beliefs, rituals and practices,
>
> and includes an association of persons that is charitable according to the law of Ontario and that is organized for the advancement of and for the conduct of worship, services or rites of the Buddhist, Christian, Hindu, Islamic, Jewish, Baha'i, Longhouse Indian, Sikh, Unitarian or Zoroastrian faith, or a subdivision or denomination thereof; [34]

Therefore, ROLA offers an unincorporated group established for religious purposes the opportunity of holding land not used for such purposes on a long-term basis. The primary downside is that the members of an unincorporated religious organization may be held liable for the obligations of the organization. Incorporation offers protection to the members from the liabilities of the corporation and has a more permanent life than an unincorporated organization. A corporation also offers a more formal structure.

Religious charities will need to weigh the benefits and risks of being unincorporated to determine whether to avail themselves of the provisions of ROLA regarding holding land.

Nonprofit Organizations

Nonprofit (or not-for-profit) organizations are common vehicles used by charities. Often, they are created to undertake activities that charities are not permitted to engage in, such as political activities. They can also be used indirectly to

assist a charity to carry on an unrelated business (but cannot carry on business activities directly), as discussed above.

Under the *Income Tax Act*, a nonprofit organization is defined as:

> a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society or association the primary purpose and function of which was the promotion of amateur athletics in Canada.[35]

The *Income Tax Act* does not limit the legal form of nonprofit organizations in any way. Nonprofits are usually set up as corporations without share capital (or non-share capital corporations), either federally or provincially, or as unincorporated entities. For purposes of protection from liability, the better form would be a corporation since a corporation is a separate legal entity distinct from its directors/trustees and members.

The benefits of forming a nonprofit organization lie in the fact that nonprofits, like charities, are tax-exempt entities[36] (although they cannot issue charitable donation receipts) and have fewer limitations on their operations than charities do. Furthermore, nonprofit organizations do not need to apply for their tax exempt status as qualification as a nonprofit is a self-assessing test. The basic restrictions on nonprofits are that they cannot operate with a profit-making motive and they cannot pay any part of their income to their members. CRA permits and encourages the use of nonprofit organizations by charities, so long as the relevant rules with respect to transferring funds and allocating costs are followed.[37]

Charities can use nonprofit organizations to carry on political activities, but the key problem with doing so is that a charity cannot transfer funds to a nonprofit organization because that organization is not a qualified donee.[38] (There are virtually no restrictions on a nonprofit transferring funds to a charity provided that the charity is not a member of the nonprofit.) However, it is easier for a charity to raise funds because it can issue charitable donation receipts. The result will be that, while structurally, nonprofit organizations will enable charities to indirectly carry out their political activities, finding the funds to do so may be very difficult.

The use of a nonprofit organization by a charity to carry on political activities can succeed if there are donors who do not require donation receipts or corporate donors who will use their donations as marketing expenses instead. In addition, a charity can retain a nonprofit organization as its agent to carry out political activities on behalf of the charity, subject to the restriction on the charity that it not devote more than 10% of its resources to such activities. If several charities

unite their political activities in one nonprofit organization, each could get a bigger bang for its bucks.

Furthermore, a nonprofit cannot carry on business activities directly because the definition of nonprofit in the *Income Tax Act* provides that nonprofits can be operated for any purpose except profit. However, as discussed above, a nonprofit can be used in conjunction with a business trust to do so, either as the trustee or as the alternative beneficiary.

If a charity uses a nonprofit corporation, it should ensure that it has and is able to maintain control over it. Control can be achieved at the membership and/or directors' levels. To provide control at the membership level, the by-laws of a non-share capital corporation could, for example, provide that the charity is the sole voting member. For non-share capital corporations incorporated in Ontario under the *Corporations Act,*[39] the directors must be members. As such, a separate class of members could be established for the directors and the membership class held by the charity could have super voting rights. Although the initial assumption would be that the charity would be the member of the nonprofit and would thereby elect the directors, a nonprofit is restricted from paying any part of its income to its members. Therefore, if the intention is for the nonprofit to pay income to a charity, the charity cannot be a member of the nonprofit.

In the alternative, the by-laws could provide control at the directors' level by, for example, stipulating that the officers of the charity shall be the directors of the non-share capital corporation. Another option is that the officers of the charity could be the directors of the nonprofit *ex officio*. Although other authors may disagree, a charity cannot be given the right to elect or appoint directors of a non-share capital corporation unless the charity is a voting member since the right to elect/appoint directors is a fundamental right of membership.[40]

As a final point on nonprofits, while it may appear that a nonprofit could be used to hold land or shares on behalf of a charity, a charity may be ill-advised to do so. The *Charities Accounting Act* and the *Charitable Gifts Act* apply to property vested in a person for "any religious, charitable, educational or public purpose."[41] It is difficult to conceive of a nonprofit organization established by a charity for a purpose other than a public purpose. As such, a nonprofit organization may not be an appropriate vehicle through which a charity should hold land or shares.

Parallel Foundations

Charities may utilize parallel foundations for several different reasons. Typically, a charity will set up a parallel foundation to create a separation between the charitable activities that the charity carries on and its fundraising activities. A charity may wish to set up a parallel foundation to create a capital base from which it will receive an income stream[42] or to segregate funds, for any of a variety of reasons, including:

- a desire to distinguish between annual and capital fundraising;
- a perceived need to protect surplus funds from future boards;
- a wish to perpetuate the names of particular donors; and
- the desire to transfer "excess funds" to a foundation so as not to affect future government funding decisions.[43]

There are certainly benefits that may accrue to charities through the segregation of funds. For instance, there are more controls in place if the organization finds itself in a cash crunch. There is an expansion of donor options (for donors committed to the charity or cause) for supporting the organization in question.

A parallel foundation is typically established by a charitable organization. Charitable organizations carry out charitable activities or are "doer" charities. Foundations are generally used to fund charities and may be classified as "funders" although they can carry out their own charitable activities. Foundations and charitable organizations are both categories of registered charities under the *Income Tax Act*. While, pursuant to the *Income Tax Act*, a charitable foundation can be a public foundation or a private foundation, for the purposes of this article, a "parallel foundation" refers to a public foundation.

Pursuant to the relevant sections of the *Income Tax Act,* a public foundation is defined as follows:

1. it must be a corporation or trust;[44]
2. it must be resident in Canada and must be created or established in Canada,[45] which, for a corporation, means that it must be incorporated in Canada[46] and generally that a majority of the board of directors or trustees must be Canadian residents;[47]
3. it must be constituted and operated *exclusively* for charitable purposes, and no part of its income may be payable or otherwise available for the personal benefit of any of its members, trustees or settlers;[48]
4. more than 50% of its directors, trustees, officers or like officials must deal with each other and with each of the other directors, trustees, officers or officials at arm's length;[49] and
5. not more than 50% of its capital can come from one person or group of persons who do not deal with each other at arm's length.[50]

The benefits of setting up an endowment through a parallel foundation are clear for organizations that plan to operate indefinitely and can cover operating costs for a second entity. However, unless there is a large gift that constitutes seed money, building an endowment takes time and requires a significant investment in volunteer and/or paid staff resources and sophisticated fundraising techniques. In addition, organizations that are not easily meeting current operating expenditures may not benefit from setting up a parallel foundation given the resources

required and long-term focus. Maintaining a second corporation requires additional resources (both human and financial)—a separate board of directors is required, a separate minute book must be kept and separate meetings must be held, and there are additional filing requirements with CRA and, if the parallel foundation is incorporated or operates in Ontario, with the PGT.

A charity must also consider and carefully plan the transfer of resources to a parallel foundation. There can be implications on employment relationships; preserving the terms of restricted gifts; intellectual property issues regarding the use of the corporate name, etc. of the charity by the foundation; potential land transfer tax; GST and PST on the transfer of real and personal property; assignments of contracts, leases, etc.; fraudulent conveyance issues; and privacy act issues.

In addition, the *Income Tax Act* limits the amount of income that a charity may transfer to another charity to 50%.[51] However, the *Income Tax Act* allows two or more charities to be associated if the charitable aim of each is substantially the same.[52] The main benefit of associated charity status is that the 50% limitation on the transfer of funds from one charity to another is lifted. Instead, associated charities can transfer up to 100% of their funds between them.[53] As well, recent amendments to the *Income Tax Act* have resulted in confusion and uncertainty with respect to inter-charity transfers. Charities that transfer funds to other charities (whether or not associated) will need to consider whether the funds should be transferred as an ordinary gift, as a specified gift, or as a gift of enduring property. The classification of a gift made between charities will have an effect on the disbursement quota of the transferring charity and of the recipient charity.[54]

Of key importance to a charitable corporation that establishes a parallel foundation is ensuring that it has control over the foundation. The case of *Bloorview Childrens Hospital Foundation v. Bloorview MacMillan Centre*[55] is an unfortunate example of what can happen to the funds of a charity which have been transferred to a foundation without proper controls in place. In that case, the Bloorview MacMillan Hospital (now the Bloorview MacMillan Centre) (the "Centre") established the Bloorview Childrens Hospital Foundation (the "Foundation") and transferred the Centre's unrestricted funds to the Foundation. For almost 20 years everything appears to have run smoothly between the two organizations, but then the Centre requested funding from the Foundation for the construction of a new hospital and the Foundation denied the funding request. The Foundation then sought a declaration from the court that it was the beneficial owner of the assets transferred to it by the Centre. The Centre's position was that it was entitled to control the funds of the Foundation. The court granted the declaration to the Foundation and rejected the Centre's position.

The objects of the Foundation provided, in part, that its funds be held for the benefit of the patients of the Centre (rather than for the Centre itself) and that the Foundation be the fund receiving body of the Centre. While there were initially

provisions in the by-laws of the Foundation that, among other things, mandated that the Centre had the right to have a majority of the directors on the Foundation's board, the by-laws of the Foundation were amended and that right was removed.

Historically, one of the ways that control was ensured was through relational provisions in the letters patent of a foundation. A relational provision is a clause that establishes a relation or link with another organization. So, for example, a charity would include in the letters patent of its parallel foundation a clause that provides that the charity must approve all changes to the letters patent of the foundation.

However, non-share capital corporations created under the *Corporations Act* (Ontario) may no longer be able to include relational provisions in their letters patent because the Ontario Ministry of Government Services (formerly the Ministry of Consumer and Business Services), Companies and Personal Property Security Branch (the "Ministry") took the position several years ago that the *Corporations Act* (Ontario) does not permit it.[56] It is arguable whether the position taken by the Ministry is supportable, but from a practical standpoint, the Ministry approves all applications for incorporation in Ontario. Therefore, in order to incorporate a corporation without share capital in Ontario, a charity will likely need to omit relational provisions from its application. Whether the Ministry will continue to take such a position regarding relational provisions is unknown.

If the Ministry will not allow relational provisions, there should be provisions in the by-laws of a foundation that put control over the approval of changes to the letters patent and the by-laws squarely in the hands of the parent charity. Such control could be achieved by making the officers of the parent charity *ex officio* directors of the foundation and requiring unanimous board approval for any changes to the letters patent and by-laws. Another method of achieving such control is to provide in the by-laws that the directors of the parent charity are the members of the foundation, *ex officio*, and any amendment of the letters patent and by-laws would require unanimous membership approval or the approval of the class of membership held by the directors of the parent charity.

National Charitable Structures: Chapter Model vs. Association Model

Some charities operate within the context of a larger group, often provincially or nationally. There are generally two different models that these national and provincial organizations use to structure their operations: the chapter model and the association model.[57] While these charities typically want to operate as a single organization across Canada, they can do so as one legal entity (the chapter model) or as multiple legal entities (the association model).

The chapter model generally consists of multiple divisions (often called branches or chapters, hence the name) at the provincial, regional, or local level or sometimes a combination. The divisions are not separate legal entities but rather, they

operate as parts of one single legal entity. The benefits of using a chapter model include (a) a higher degree of control by the national/provincial organization over its divisions, (b) greater simplicity in operations, which can be centralized, and (c) no risk of losing control of the charity's assets or goodwill to an insurgent division.

The association model, on the other hand, consists of numerous separate legal entities rather than one single corporation. Although there is often an umbrella corporation that acts as the parent organization or governing body, the provincial, regional, and local divisions are separately incorporated, usually provincially. As discussed above, the association of two or more charities is specifically recognized and permitted by the *Income Tax Act*.[58]

Some of the benefits of using an association model include the following: (a) liability exposure is reduced by containing liabilities within separate corporations, (b) the liability risks of one division will not affect the assets of the other divisions or of the parent organization, and (c) a separate Ontario corporation for Ontario operations can limit the jurisdiction of the Public Guardian and Trustee, the *Charities Accounting Act,* and the *Charitable Gifts Act* of Ontario.

There are several pitfalls related to the association model. It can be difficult for the "parent" charity to maintain effective control over its branches or chapters. Disagreements regarding the future direction of the group of charities can arise which can result in one or more of the divisions breaking away from the group. If each division is separately incorporated, a division can break away with its assets, including its name. Often, proper controls are not put in place when the structure is first established which would allow the parent charity or other divisions to stop the disaffiliation and the only means of trying to prevent it is by costly litigation. A renegade charity would then be on the loose competing for donors' dollars under the same name.

Even if all divisions are generally working together, confusion in the fundraising arena can arise. Donors may not know which arm, of what they see as the same charity, they should donate to.

One method of addressing these pitfalls is to use contracts and licensing agreements pursuant to a franchise model. In essence, the parent charity would enter into a contract with local charities, which could address such issues as use of the corporate name, requirements for objects and purposes, jurisdiction of operations, sharing of fundraising revenue, etc. The contract would also set out the consequences of breaching the terms of the contract.[59]

Conclusion

The increasing demands on the charitable sector to operate efficiently and effectively and competing demands on charitable dollars call for innovative structuring solutions to navigate the restrictive and fragmented legal framework in which charities operate. The effective use of business trusts, nonprofit organizations,

share capital corporations, parallel foundations, and provisions in charity's charter documents will enable charities to minimize liability, implement controls, and enhance profitability through participation in income generating endeavors.

NOTES

1. For purposes of this paper, "corporate structures" includes trusts and unincorporated entities.
2. *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.), as amended, ss. 149.1(2)(a), 3(a) and 4(a).
3. *Ibid.* at ss. 188.1(1) and (2).
4. For more details, see: Linda J Godel, "Investment Powers of Trustees," The 2nd National Symposium on Charity Law: "What's New and What's Coming," The Canadian Bar Association, April 14, 2004.
5. According to the Canada Revenue Agency, substantially all means 90% or more. See CRA Summary Policy CSP – S16 dated September 3, 2003 (Revised November 23, 2005) at <http://www.cra-arc.gc.ca/tax/charities/policy/csp/csp-s16-e.html>.
6. See, for example, *Alberta Institute on Mental Retardation v. The Queen*, [1987] 2 C.T.C. 70, 87 D.T.C. 5306, 1987 Carswell 442, 1987 CarswellNat 860 (F.C.A.); leave to appeal to S.C.C. refused [1988] 1 S.C.R. xiii, 87 N.R. 397 note [1988] S.C.C.A. No. 52; *Earth Fund* v. *Canada (Minister of National Revenue)*, [2003] 2 C.T.C. 10, 2003 D.T.C. 5016 (F.C.A.).
7. CRA Policy Statement CPS – 019, dated March 31, 2003, What is a Related Business? at <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html>.
8. *Ibid.* at para. 4.
9. Including (a) the intended course of action, (b) the potential to show a profit, (c) the existence of profits in past years, and (d) the expertise and experience of the person or organization that undertakes the activity. *ibid.*, para. 4.
10. R.S.O. 1990, Chapter C.10.
11. The Office of the Public Guardian and Trustee is part of the Family Justice Services Division of the Ministry of the Attorney General, Ontario, Canada. It is responsible for protecting the public's interest in charities in Ontario. (See: <http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/>.)
12. Public Trustee for Ontario, "Submissions to the Ontario Law Reform Commission: Project on the Law of Charities" (1990–91) 10 E. & T. J. 272.
13. *Income Tax Act*, ss. 149.1(6.1) and (6.2). See also Arthur B.C. Drache, *Canadian Taxation of Charities & Donations*, (Thomson Canada Limited, 2005) starting at page 1–16.1 for a discussion on political activities.
14. *Supra* at note 5.

15. CPS - 022 dated September 2, 2003 at <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-022-e.html> at para. 2.

16. *Income Tax Act*, s. 110.1(1)(a).

17. *Ibid.* at s. 149.1(1), definition of "disbursement quota."

18. *Supra* at note 13 at 9–18.

19. *Income Tax Act*, s. 149.1(1), definition of "disbursement quota". For charitable organizations that were registered before March 22, 2004, the 3.5% obligation will commence for fiscal periods that begin after 2008. See also Regulation 3702(1) of the *Income Tax Act* regarding the determination of the value of the shares.

20. R.S.O. 1990, Chapter C.8.

21. *Charitable Gifts Act*, s. 3(2).

22. *Ibid.* at s. 3(3).

23. *Ibid.* at s. 4.

24. *Ibid.* at s. 9.

25. Donavan W.M. Waters, Q.C., *Waters' Law of Trusts in Canada*, Third Edition (Toronto: Thomson Canada Limited, 2005) at 2.

26. *Ibid.* at 2.

27. A "qualified donee" under the *Income Tax Act* is an organization that can issue official donation receipts, namely: a registered charity; a registered Canadian amateur athletic association; a housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged; a Canadian municipality; the United Nations and its agencies; a university that is outside Canada that is prescribed to be a university the student body of which ordinarily includes students from Canada; a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift during the fiscal period or in the 12 months immediately preceding the period and Her Majesty in right of Canada or a province"; *Income Tax Act*, s. 149.1(1).

28. See CRA Information Letter CIL – 1998–026 dated September 15, 1998 at <http://www.cra-arc.gc.ca/tax/charities/policy/cil/1998/cil-026-e.html>.

29. *Income Tax Act*, s. 104(2).

30. *Ibid.* at s. 104(6).

31. See Regulation 3702(1)(v) and (vii) of the *Income Tax Act* regarding the determination of the value of the charity's interest in the trust.

32. *Income Tax Act,* s.104(4); *supra* at note 13 at 9–20.

33. R.S.O. 1990, Chapter R.23.

34. *Ibid.* at s. 1(1).

35. *Income Tax Act*, s. 149(1)(l).

36. *Ibid.* See exception in s. 149(5) regarding nonprofit "clubs" that provide dining, recreational or sporting facilities.

37. S*upra* at note 13 at 9–16.

38. *Supra* at note 27.

39. R.S.O. Chapter C.38.

40. *Ibid.* at s. 287(1) which provides that "[t]he directors shall be elected by the shareholders or members in general meeting and the election shall be by ballot or in such other manner as the by-laws of the corporation prescribe." In addition, s. 127 provides that "[s]ubject to section 286, the letters patent, supplementary letters patent or by-laws of a corporation may provide for persons becoming directors by virtue of their office, in lieu of election."

41. *Charities Accounting Act*, s. 1(2); *Charitable Gifts Act*, s. 2(1).

42. Jane Burke-Robertson, "Establishing a Parallel Foundation: Why? Why Not? How?" *The Philanthropist,* Volume 13, No. 2 at 4.

43. *Ibid.* at 6.

44. *Income Tax Act*, s. 149.1(1).

45. *Ibid.* at s. 248(1).

46. *Ibid.* at s. 250(4).

47. S*upra* at note 13 at 3–12.

48. *Income Tax Act*, s. 149.1(1).

49. *Ibid*., s. 149.1(1).

50. *Ibid*., s. 149.1(1). In computing sources of contributions for the purposes of this test, contributions from Her Majesty in right of Canada or a province, a municipality, another registered charity that is not a private foundation or a nonprofit organization described in paragraph 149(1)(l) of the Act are not included. Legislative proposals were released by the Department of Finance on July 18, 2005 to, among other things, amend the definition of "public foundation" in the *Income Tax Act* retroactively to January 1, 2000 so that a public foundation may receive more than 50% of its capital from a person or group of persons not dealing at arm's length with each other provided that such person or group of persons does not in any way control the charity and more than 50% of the directors, trustees, officers or like officials may not come from such group.

51. *Income Tax Act*, s. 149.1(6)(b).

52. *Ibid.* at s. 149.1(7).

53. *Ibid.* at s. 149.1(6)(c).

54. For a more detailed discussion, see Theresa L.M. Man and Terrance S. Carter, "Effect of Inter-Charity Transfers on Disbursement Quota Calculation under Bill C-33" Charity Law Bulletin No. 69, April 12, 2005 at <http://www.carters.ca/pub/bulletin/charity/2005/chylb69-05.pdf>.

55. [2002] O.J. No. 521 (Sup. Ct.) (QL).

56. See: Jacqueline M. Connor and Terrance S. Carter, "Update on Use of Relational Provisions by Ontario Non-Share Capital Corporation" Charity Law Bulletin No. 22, June 26, 2003 at <http://www.carters.ca/pub/bulletin/charity/2003/chylb22-03.pdf>.

57. For a more detailed discussion, see Donald J. Bourgeois, *Charities and Not-for-Profit Administration and Governance Handbook*, (Butterworths Canada Ltd., 2001) starting at page 169.

58. *Income Tax Act,* s. 149.1(7): A registered charity may apply to become associated with one or more other charities if the charitable aim of each is substantially the same.

59. For a more fulsome discussion on this topic, see "Pro-active Protection of Charitable Assets," Law Society of Upper Canada November 2001 at: <http://www.carters.ca/pub/article/charity/2001/proactiv.pdf.>