Gifts Involving Foreign Entities*

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Special considerations arise when gifts are made by individuals, corporations or charities in Canada to foreign charities, and gifts are made by individuals, corporations or other foreign entities to Canadian charities.

There are always two bodies of law which must be considered when gifts are made to, or by, any charity whether there is a foreign component or not. One body of law is the common law which governs such matters as whether a particular activity or entity is a charity and whether the directors or trustees or other officers have carried out their trust properly and to the benfit of the charitable beneficiaries. In Ontario, the Public Trustee, acting on behalf of the Attorney General, is responsible for ensuring that charities operate properly under the law. In other provinces, the Attorney General, acting as protector of charity, has authority to ensure that such laws are upheld.

The other body of law that applies to charity in Canada is found in the statutory rules in the *Income Tax Act (Canada)* and the *Regulations* thereto and the case law interpreting such rules which give certain tax concessions to charities which are registered for income tax purposes and comply with those rules. Because Revenue Canada has become the main regulatory authority in Canada for charities, its rules are often considered paramount. The other common law rules are, however, just as important although the consequences of breaking them might not be as severe as those arising from a breach of rules under the *Income Tax Act.*

With respect to the general law, if a Canadian charity is an association, trust or corporation, it can carry on its activities in Canada and anywhere in the world if its constitution, trust agreement, or Letters Patent so provide. There are no limitations under the general law which would require it to operate only in Canada unless such limitations are embodied in the constating documents of the charity or in applicable legislation, e.g., statutes governing the incorporation and operation of corporations which carry on charitable activities. These powers are not limited by the *Income Tax Act* of Canada and, accordingly, a corporation, trust or association in Canada is not restricted by the *Income Tax Act* or the Regulations thereto if it wishes to carry on activities abroad.

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Donations to Foreign Charities

As you know, charities which are registered under the *Income Tax Act* of Canada must spend, each year, the amounts stipulated in Section 149.1 of the *Income Tax Act* of Canada either on their own activities or by way of gifts to qualified donees. To the extent that a charity has met its disbursement requirement in a particular year, it can, if authorized by its constating documents (trust agreement, Letters Patent or constitution, etc.) expend further monies by way of donations to other charities.

Gifts to Qualified Donees

The *Income Tax Act* provides that Canadian charities may give to qualified donees. Qualified donees are defined in paragraph 110(1)(a) as including, among others, the United Nations or agencies thereof, universities outside Canada which are prescribed in the regulations, and charitable organizations outside Canada to which Her Majesty in Right of Canada has made a gift during the taxpayer's taxation year or the 12 months immediately preceding that taxation year. Charities in Canada may make gifts to such organizations outside Canada and meet their expenditure requirements for income tax purposes.

Care should be taken to ensure that the recipients of such gifts are, in fact, charities as the common law requires charities to support only purposes which are, under Canadian law, charitable. Charities in Canada cannot support purposes which are not in law charitable, even though such purposes might be recognized for tax relief for Canadian income tax purposes.

Donations to Charities Which are Not Qualified Donees

Charities in Canada which have met their disbursement requirements for the year may make donations to charities which are not qualified donees for income tax purposes. They should make sure that such donations are made for charitable purposes exclusively, first, so they comply with the requirement in section 149.1 of the *Income Tax Act* that they expend all of their resources on charitable purposes and, secondly, so that they satisfy the requirements of the general law that charities expend their resources on charitable objects.

Carrying on Activities Abroad

If a charity wishes to support activities abroad and it is not possible to channel the funds through a foreign entity which is a qualified donee or to support such activities through a foreign charity out of funds which will not qualify as permitted disbursements for Canadian income tax purposes ("excess disbursements"), the Canadian charity may carry on the activities abroad itself. It can either do this by having its own staff carry out the activity directly or by using a properly appointed agent or representative.

Revenue Canada has recognized in Information Circular 80-10R that charitable activities may be carried on by a Canadian charity abroad through an agent. Paragraphs 18 and 19 of Information Circular 80-10R provide that:

A registered charity may administer its own charitable activity through an appointed agent or representative. Such an arrangement should be established under a formal agreement between the charity and its agent. To satisfy the requirement that a charity devote its resources to charitable activities carried on by itself, funds transferred to an agent must be expended strictly in furtherance of the charity's own purposes. A satisfactory agency relationship does not exist where funds are supplied by a charity simply to fund projects of another organization. Funds may, of course, be transferred to an organization that is a "qualified donnee". Most organizations outside Canada do not qualify in that category. The Department would be pleased to provide assistance in cases of doubt.

In carrying on its activities through an agent, a charity must ensure that the following conditions concerning expenditure of its funds are fulfilled:

(a) the charity must maintain direction, control and supervision over the application of its funds by the agent,

(b) the charity's funds must remain apart from those of its agent so that the charity's role in any particular project or endeavor is separately identifiable as its own charitable activity,

(c) the financial statements submitted in support of the charity's annual information returns must include a detailed breakdown of expenditures made in respect of the charitable activities performed on behalf of the charity by its agent(s), and

(d) adequate books and records must be kept by the charity and its agent(s) to substantiate compliance with the conditions outlined above.

It is important to make sure that these conditions are met so that the charity will continue to qualify for registration as a charity for income tax purposes in Canada.

Agency Agreement

As a general rule, the Canadian charity should enter into a contract with a foreign entity whereby the foreign entity agrees to perform services which should be described in the agreement. Such foreign entity can be paid a fee for its services. The agreement should make it clear that the foreign entity is acting as an agent and the Canadian charity as the principal. Care must be taken to ensure that the foreign entity is not, in law, acting as principal in connection with the activity. The Canadian principal would be responsible for making all major decisions in connection with the foreign activity, and, to the extent funds were disbursed by the foreign agent, the foreign agent would, in effect, treat the funds transferred to it as trust funds expended on behalf of the Canadian charity.

Filing Requirements

Form T3010 *Registered Charity Information Return and Public Information Return* has recently been revised. It combines the two forms T3010 *Public Information Return* and T2052 *Information Return* that a registered charity

was previously required to file. This new form is the only form that a registered charity that is a corporation is required to file with Revenue Canada as the provisions requiring the filing of a corporate income tax return were repealed, effective for 1983 and subsequent taxation years.

The revised Form T3010 is four pages and, in essence, asks for the same information that was required by the previous Form T3010 whereas the information required by the previous Form T2052 and the corporate income tax return relating to disbursement quota are now contained in Schedules 1 to 4. The information furnished on these four schedules is only to be viewed by Revenue Canada, Taxation and is not for public viewing. In addition to the form and the schedules, Revenue Canada, Taxation has released a publication entitled *Guide to Charity Information Return* which comments in some detail on the revised form and the four schedules.

Part III of the return deals with activities outside Canada. Revenue Canada has commented on this portion of the return in the *Guide to Charity Information Return* as follows:

> III Activities Outside Canada
> In this part, please describe the activities the charity has carried on outside of Canada. This would include any activities which were carried out on behalf of the charity by its agents or authorized representatives.
>
> Please note:
> (a) The employees of the charity referred to in this part are those persons with whom the charity maintains an employer-employee relationship;
>
> (b) The terms 'agent(s)' or 'authorized representative(s)' in this part refer to individuals or organizations who by virtue of a formal written agreement are funded by the charity in order to carry out the charity's activities on its behalf;
>
> (c) This part refers to any activities and programs which the Canadian charity carries on in conjunction with foreign charities. This type of relationship must also be governed by a formal written agreement which clearly defines the responsibilities of both parties.

Obviously, Revenue Canada is intending to monitor the activities of Canadian charities abroad more closely than it has in the past. It is therefore important to ensure that the conditions and guidelines stipulated by Revenue Canada are followed.

Ownership of Assets

If the Canadian charity wishes to fund a capital project abroad, as noted above, it must build the project itself directly or through an agent. As the Canadian charity cannot fund non-qualified donees, and assuming it would, or could not fund the project out of its excess disbursements, it must have title to, and own, the project. It cannot build or acquire capital assets for a foreign entity or make

gifts to a foreign entity. It could, however, sell the asset once constructed to a foreign entity in return for proceeds equal to the fair market value of the asset sold.

As in the case of most rules, there are exceptions. In this case, it is understood that if the laws of the foreign jurisdiction preclude a Canadian charity from owning assets in that jurisdiction, and the Canadian charity satisfies Revenue Canada that the project is charitable and that the assets will be owned by a foreign entity which is charitable and that they will be used for charitable purposes only, Revenue Canada may permit foreign ownership of capital assets funded by a Canadian charity. Further, in the case where a foreign project involves, for example, the building of a well in a poor area without water or other such assets of small value, and Canadian ownership of the asset is not appropriate, Revenue Canada may consider the construction of such asset to be a charitable activity in itself which may be carried on by the Canadian charity (either by its own staff or through an agent) snd will not insist that the assets be owned by the Canadian charity.

Gifts Received by Charities from Non-Residents and Non-Resident Charities

Charities in Canada may receive gifts from non-resident individuals and non-resident charities. As a general rule, such individuals and organizations would not be entitled to deduct such contributions for Canadian income tax purposes and therefore would not require an official income tax receipt from the Canadian charity. The recipient Canadian charity should take care not to issue official income tax receipts where these are not required as receipted donations are taken into account when the disbursement requirements of a charity are determined. In such case where the donor does not require an official income tax receipt, an ordinary receipt should be issued for the gift.

It should also be noted that, under the definition of "disbursement quota" in paragraph 149.1(1)(e) of the *Income Tax Act,* private and public foundations are not required to include in their disbursement quotas amounts received from a non-resident charity.

In certain cases, a non-resident donor (usually an individual or a corporation) may request an official tax receipt for a donation made to a Canadian charity. For example, under Article XXI5. of the *Canada-United States Income Tax Convention (1980),* a citizen or resident of the United States may deduct contributions (up to 50 per cent of adjusted gross income for individuals and 10 per cent for corporations) made to a registered Canadian charity out of income taxable in Canada provided the Canadian charity could qualify in the United States to receive deductible contributions if it were resident in the United States. Unused contributions may be carried forward for five years.

A major problem can arise if a foreign charity wishes to donate a large amount to a Canadian charity, whether or not the donor requires an official income tax receipt for the donation.

Where a charity applies for registration after February 15, 1984, it will be classified for income tax purposes as a charitable organization or a public foundation or a private foundation and, if more than 50 per cent of its capital has been contributed to, or otherwise paid to, the organization by one person or a group of persons who do not deal at arm's length, other than Her Majesty in Right of Canada or a province, a municipality, another registered charity that is not a private foundation or a non-profit association (see paragraphs 149.1(1)(b) and 149.1(1)(g)), it will not meet the definition of a charitable organization or public foundation. The same rule would apply to charities which were registered prior to February 15, 1984, but designated by the Minister under the rules which came into force effective February 15, 1984 (subsections 110(8.1) and (8.2)).

The rule was introduced to prevent private foundations from taking over charitable organizations, however, it appears to apply where a connected foreign charity wishes to fund a Canadian operation which wishes to carry on its own activities and not to operate as a private foundation. For example, such a charity, which received more than 50 per cent of its capital from a related foreign charity, could not carry on a business even if such business were connected with its charitable activity. The wording of subsections 110 (8.1) and (8.2) appears to give the Minister discretion, however, it is understood that the Charities Section of Revenue Canada considers there is no discretion regarding the classification of a charity in such circumstances. If a charity falls within one of the definitions, in the Department's view, it must be registered that way.

Operation of Foreign Charity In Canada

Assuming a foreign charity had the necessary power, under its constating documents, to operate in Canada, it could do so. It could not, however, become a registered charity for income tax purposes.

In order to become registered for income tax purposes in Canada, a charity must be resident in Canada and must have either been created or established in Canada and must have made an Application for Registration in prescribed form (paragraph 110(8)(c)). A foreign charity which operates in Canada cannot be registered under the *Income Tax Act* of Canada.

If a charity wishes to operate in Canada and does not wish to use a Canadian agent or to fund a Canadian charity, it must create a trust, corporation or other legal entity in Canada and register such entity as a charity for income tax purposes. A major difficulty, which may preclude foreign charities from commencing operations in Canada through a Canadian charity which is registered for income tax purposes, is the requirement, discussed above, that where a charity applies for registration after February 15, 1984, it will be classified for income tax purposes as a charitable organization or a public foundation or a private foundation and, if more than 50 per cent of its capital has been contributed by one person or a group of persons who do not deal at arm's length, it will not meet the definition of a charitable organization or public foundation and

must operate as a private charity. This means that such charity could not carry on any business activities and would be restricted to the rules applicable to private charitable foundations.

In certain cases, the foreign charity may be able to operate in Canada through an agent and it will not be necessary to register as a charity. In other cases, however, this rule will pose difficulties for foreign charities which wish to set up operations in Canada if more than 50 per cent of the funding from such operation will be from one source. If less than 50 per cent of the funding will be from one source, this, of course, would not preclude it from establishing a charity in Canada which could operate either as a charitable organization, a public foundation or a private foundation.