



# NONPROFIT ORGANIZATIONS COMMITTEE NEWSLETTER

Second Quarter, 2018

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Emily Chan, San Francisco, CA  
Matthew G. Wright, Waco, TX

### Canada Report: Utility Vehicle: Worldwide Use of Canadian Charitable Foundations

*By: Daniel Frajman*

This article examines the main features of the Canadian charitable foundation structure: tax-free status; issuer of Canadian tax receipts; requirement to have charitable purposes and activities as established at common law; an ability to have assets deposited and activities carried out internationally; requirement to have direction and control over activities, helping to avoid "vanity charities"; directors may not have to be Canadian, as the required Canadian residency for the foundation is satisfied by incorporation in Canada; and the ability for the founder to keep control if donations are not solicited from the public. These features can make the Canadian charitable foundation attractive. In addition, American charities should be aware that a Canadian charitable foundation (or charitable organization), often called a Canadian Friends Organization, is usually required in order to provide tax relief to Canadians donating funds for charitable work in the US.

*This article, by Montreal attorney Daniel Frajman, of the firm Spiegel Sohmer Attorneys, was first published in the STEP Journal, Volume 26, Issue 4.*

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## UTILITY VEHICLE

Daniel Frajman explains how philanthropists across the world can make use of Canadian charitable foundations

### ➔ KEY POINTS

#### WHAT IS THE ISSUE?

Persons interested in philanthropy may not have a vehicle practical for carrying out charitable works in their home jurisdiction. They should consider forming a Canadian private foundation, which can usually operate worldwide.

#### WHAT DOES IT MEAN FOR ME?

Philanthropists, including non-Canadians, can likely establish and control a Canadian private foundation.

#### WHAT CAN I TAKE AWAY?

A Canadian private foundation is set up under recognised and monitored rules, and can be a secure vehicle for a charitable endowment.

PHILANTHROPISTS IN SOME parts of the world may find themselves in a quandary. Although they would like to set aside funds clearly marked for a charitable use in their country of residence (Home Country), the Home Country lacks legislation or practice allowing this to be easily done.<sup>1</sup> A solution may be to establish a charitable foundation in Canada, which will be able to carry out charitable works in the Home Country. This article contains a creative review of the features of the Canadian charitable foundation (particularly the private foundation) and so demonstrates how this solution may be carried out.

#### REGISTERED CANADIAN CHARITIES

The Canadian federal *Income Tax Act* (ITA)<sup>2</sup> sets out rules for establishing charities.<sup>3</sup> Those rules are expanded on in published guidance issued by the Canada Revenue Agency (CRA), by case law, and by federal and provincial rules mostly relating to the formation of corporations and trusts. Some of the principal rules are as follows:

- Canadian charities can carry out their charitable works anywhere in the world, without a requirement to do so in Canada.
- A Canadian charity is first established as an organisation, usually a non-share capital corporation (with members, who

appoint a board of directors that manages the corporation and can appoint officers), or sometimes a charitable trust. Perhaps because third parties are receptive to working with corporations, and because standard corporate law should apply so as to more readily limit the liability of members, directors and officers, the non-share capital corporation, rather than the trust, has become the vehicle of choice. Often, the corporation will be incorporated under the federal *Canada Not-for-profit Corporations Act*<sup>4</sup> (CNCA), a modern statute that has been in force since 2011. The application for registered charitable status is filed with the CRA on behalf of the organisation. To receive charitable status, it must be shown in essence that the organisation's proposed purposes and activities are charitable, as defined under Canadian charity law.

- What is charitable is not defined in the ITA or other legislation; rather, in Canada, it is established by common law (essentially set out in a 19th-century decision of the UK House of Lords)<sup>5</sup> as being the work of those organisations established in service of one or more of the so-called four 'heads of charity'. These are: for the relief of poverty; for the advancement of education; for the



advancement of religion; or for other purposes beneficial to the community.

- The application to the CRA is often a streamlined process, submitted on a prescribed form, and, if properly prepared, charitable status is typically granted in three to six months. So long as the proposed activities of the organisation allow for it, it is key, when preparing the application, to properly characterise the organisation's purposes and activities as being for public benefit and falling under one or more of the heads of charity. The CRA can later review and audit the charity's activities to verify that they are charitable and follow stated purposes, and the charity files with the CRA an annual information return that reports, for example, on activities and financial statements.
- The charity is exempt from Canadian federal and provincial income tax. Donations to the charity provide the donor with a Canadian tax credit of roughly 50 per cent (for individual donors) or a Canadian tax deduction (for corporate donors) equal to the corporate donor's tax rate.

#### CANADIAN RESIDENCE

The Canadian charity can operate anywhere in the world, but it must have been created or established in Canada (forming a Canadian non-share capital corporation or Canadian charitable trust will satisfy this), and must reside in Canada.<sup>6</sup> Conveniently, if the charity is incorporated in Canada, it will be deemed to reside in Canada.<sup>7</sup> Compare this to a Canadian charitable trust, which requires that management and control of the trust be in Canada in order for the trust to reside in Canada.<sup>8</sup> Therefore, it appears possible for the Canadian charity established as a corporation to have directors, and an asset base, that are not in Canada. Notably, the CNCA, under which federal corporations are incorporated, does not impose a residency requirement on directors. The ITA, however, does require that the books and records of the charity be kept in Canada, and the CNCA requires that the

charity have a registered office in Canada. Additionally, the charity may decide that it wishes to place its endowment in Canada, although this is not a requirement.

As the members of the charity appoint the board, it could be foreseen that these members, while maintaining their status as such, would be the same as the directors, and would include (and could be entirely composed of) the philanthropist-founder and their family. The founder could even be the sole member, and although a minimum of three directors are usually required, the founder could even be the sole director under the federal CNCA, so long as the organisation does not solicit donations from the public. For a CNCA corporation, the directors can be members, but need not be so.

#### CHARITABLE ACTIVITIES

As the organisation is controlled at the board level by related persons, and because the principal funder of the organisation, at any one or more times, is likely to be related to the persons controlling the board, the organisation is classified under the ITA as a 'private foundation', and not a 'public charity'. As a private foundation, the charity is not allowed to carry on a business (i.e. although it may have passive investments such as a portfolio of marketable securities, and even real estate if passively invested, it cannot carry on a charitable activity with the intention of earning a profit), but this should not hinder the charity from carrying out material philanthropy.

For example, in the Home Country, the charity as a private foundation could:

- Carry out one or more charitable activities under one or more of the four heads of charity, therefore resisting the conventional wisdom that limits a private foundation to the traditional function of only donating funds to other Canadian charities. However, to do this, it is necessary for the charity to intend not to earn a profit through the activities. For example, in the Home Country, the charity could perhaps provide seminars for all interested nurses and doctors on certain new healthcare procedures. The

seminars would have a detailed plan or syllabus, and learning by attendees of the seminar material would be assessed. The charity would finance the seminars, but earn little or no revenue from them, so would earn no profit. Applicable laws in the Home Country would have to be respected. Such purposes and activities may well satisfy at least two of the four heads of charity: advancement of education and other purposes beneficial to the community.<sup>9</sup> The charity would have to maintain direction and control (through an agent, for example) over how these activities were carried out.

- Donate funds to universities located worldwide, including in the Home Country, if the universities in question are on an extensive list, established under the ITA, of universities that are ordinarily attended by Canadians. This can be a way for the charity, through a university, to place funds in the Home Country for good works, but without the charity having to maintain the same direction and control over use of the funds required in the preceding example.

#### CONCLUSION

Philanthropists and their advisors should know that a Canadian private foundation can be an appropriate vehicle for carrying out philanthropy worldwide. As this brief review shows, such an organisation has a number of interesting characteristics: initial and ongoing review of the foundation's purposes and activities by the CRA, thereby promoting recognised good governance; the ability for founders to retain control of the foundation; the benefit of a long-standing body of law and administrative practice setting out the applicable rules; the security of a jurisdiction such as Canada, where deposit and investment of the foundation's endowment is available on a tax-free basis; and disbursement of the endowment for use anywhere in the world.

<sup>1</sup> Although likely applicable to some charities in every country, for one example, see Sarah Hasselbarth, *Islamic Charities in the Syrian Context in Jordan and Lebanon*, Bibliothek der Friedrich-Ebert-Stiftung (2014), bit.ly/2pPLDkZ, which refers to charities in Jordan and Lebanon carrying out valuable work, but which, in that author's view, do not always meet donors' transparency requirements. <sup>2</sup> RSC 1985, c 1 (5th Supp). <sup>3</sup> Primarily at s149.1. <sup>4</sup> SC 2009, c 23. <sup>5</sup> *The Commissioners for the Special Purposes of Income Tax v Pemsel* [1891] AC 531. <sup>6</sup> ITA, s248(1). <sup>7</sup> ITA, s250(4). <sup>8</sup> *Fundy Settlement v Canada*, 2012 SCC 14. <sup>9</sup> See the Supreme Court of Canada decision of *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10.



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