

# Canada

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## I. Summary

## A. Types of Organizations

Canada is a federal jurisdiction with ten provinces and three territories. There are no statutory requirements, under either federal or provincial law, governing the legal form under which a not-for-profit entity must be organized. The most common legal forms are:

1. "Non-share" (membership) corporations, incorporated under either federal or provincial law. Federal corporate legislation is most commonly used where the organization is operating in more than one province or internationally. Provincial legislation is used most often when the organization is operating within a single province or territory.
2. Trusts, which are recognized in common law provinces. Quebec, which is a civil law jurisdiction, also recognizes forms similar to trusts.
3. Unincorporated organizations or associations.

With the exception of federal incorporation, the creation of any organization is a function of the applicable provincial law, which varies somewhat, but seldom substantially, from province to province.

## B. Tax Laws

### 1. General Classification

The federal tax legislation in Canada makes distinctions among not-for-profit organizations that may be relevant for U.S. donors. Canadian federal income tax law distinguishes between "non-profit organizations" (hereinafter "NPOs") and "registered charities" (hereinafter "charities"). Although most potential grantees in Canada will be "charities," it is possible that NPOs may also seek funds from U.S. donors (NPOs may be organized for social welfare and civic improvement purposes).

To qualify as an NPO, an entity must meet three tests. First, it cannot be a charity or an organization that could be registered as a charity. Second, it must be organized and operated exclusively for a purpose other than profit. Third, no part of its income may be paid or made available for the personal benefit of any proprietor, member, or shareholder (with an exception for amateur athletic organizations).

The category of "charities" is divided into charitable organizations and charitable foundations (consisting of private foundations and public foundations). A charitable organization, whether or not incorporated, must devote its resources to charitable activities carried out directly by the organization. A charitable foundation must provide funding to other charitable organizations, although it can also directly engage in charitable activities. Charities, like NPOs, are subject to the non-distribution constraint.

### 2. Income Tax Exemption and Tax Treatment of Donations

Canada recognizes a statutory list of organizations which are not technically "charities" but which are treated as such for the purpose of giving tax relief for donations. These organizations, together with charities, are collectively known as "qualified donees." Neither NPOs nor qualified donees are subject to income taxation of any sort. Individuals are entitled to a tax credit (as opposed to a deduction) for contributions to qualified donees. Corporations, however, receive a tax deduction for their donations to qualified donees.

### **3. Other Tax and Fiscal Provisions**

Canada has a 5% federal tax known as the Goods and Services Tax ("GST"). The GST does not apply to foreign grants. Moreover, while charities and NPOs are subject to the regime, there are many potentially applicable exemptions. There are no particular customs exemptions for charities or NPOs. Real property taxes, which are part of provincial and/or municipal jurisdiction, are applied on a haphazard basis depending upon the jurisdiction.

## **II. Applicable Laws**

There are potentially fourteen different jurisdictions with laws applicable to NPOs and charities, but clearly the most important is the federal government. Key federal legislation consists of:

- The Income Tax Act;
- The Canada Corporations Act;<sup>[1]</sup> and
- The Charities Registration (Security Information) Act. [\[2\]](#)

While the provinces have jurisdiction over charities, there is a paucity of legislation in this area; instead, most provinces rely primarily on the common law powers of the Attorney General to act when there has been a breach of fiduciary duty. However, Ontario and Alberta have enacted legislation which is of some consequence, namely:

- The Charities Accounting Act (Ontario) <sup>[3]</sup>;
- The Religious Organizations Land Act (Ontario); and
- The Charitable Fund-Raising Act (Alberta).

Also relevant are the Trustee Acts of all provinces.

Each province also has legislation which deals with the incorporation of corporations without share capital.

### **Other Legal Authorities Consulted in Preparing this Note:**

The best single source of information about the federal regulation of charities and NPOs is found at the website of the Charities Directorate of the Canada Revenue Agency

(CRA) ([www.cra-arc.gc.ca/charities/](http://www.cra-arc.gc.ca/charities/)). This site has interpretation bulletins, forms, newsletters and a searchable database for registered charities.

The definitive work on the incorporation of NPOs and charities in Canada, covering all jurisdictions is *Non-Share Capital Corporations* by Jane Burke-Robertson and Arthur B. C. Drache. It is published by Carswell, the Canadian arm of Thomson Professional Publishing.

The pre-eminent source of all law relating to charities and non-profits is the multi-volume work entitled *Charities Taxation, Policy and Practice* by Arthur Drache and Robert Hayhoe, also published by Carswell.

### III. Relevant Legal Forms

Neither federal nor provincial law sets forth requirements for the organizational form of an NPO or charity. The most common forms are "non-share" corporations, trusts, and unincorporated organizations or associations. The federal Income Tax Act [4] does, however, distinguish between NPOs and charities – a distinction that may prove useful in making equivalency determinations.

#### 1. NPOs

The primary definition of a non-profit organization is:

"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...." [Paragraph 149(1)(l), Income Tax Act]

The term "club, society or association" includes corporations and trusts. The key test is that the pursuit of profit cannot be a purpose. But this does not mean that activities generating a profit are forbidden, so long as the motive for the activity is not the generation of profit. Also, because the Income Tax Act does not require registration of NPOs; in essence, they self-assess their status.

#### 2. Charities

The Canada Revenue Agency distinguishes between "charitable organizations," "public foundations," and "private foundations" based on the entity's structure, source of funding, and mode of operation. As a practical matter, charitable organizations are operational charities, while foundations are almost always grantmakers.

##### *Charitable Organizations*

A registered charity is designated as a "charitable organization" if:

- a) it devotes its resources mainly to charitable activities conducted by itself; and
- b) more than 50% of its directors/trustees deal with each other at arm's length (i.e., individuals not related by blood, marriage, common law relationships, or close business ties).

#### *Public Foundations*

A registered charity is a "public foundation" if:

- a) it is constituted and operated exclusively for charitable purposes; and
- b) it is a corporation or a trust.

A public foundation must also meet condition b) for charitable organizations. [5]

#### *Private Foundations*

A registered charity is a "private foundation" if:

- a) it is constituted and operated exclusively for charitable purposes;
- b) it is a corporation or trust; and
- c) it is not a "charitable organization" or "public foundation."

A private foundation is one where more than 50% of the board is not at arm's length with each other.

Grants to private foundations may raise "out of corpus" and other issues for U.S. donors. For a detailed discussion of issues arising with grants to private foundations (as defined under U.S. law), please see *Beyond our Borders*, page 35-36.

## **IV. Public Benefit Status**

NPOs do not need to serve the public benefit. Indeed, most of the major NPOs in Canada are organized for the benefit of their members. Such organizations include professional bodies such as the Canadian Bar Association, sporting and social clubs, labor unions, and political parties. However, since NPOs may be organized for social welfare purposes, it is possible that an NPO may seek funds from a U.S. donor.

In contrast, charities must satisfy the common law test of "charity." There is no federal or provincial statutory definition of this term, and the concept of what constitutes charitable activities draws heavily on traditional English common law dating back several centuries. Over the years, the courts have generally based their interpretation of "charity" on four categories described in English common law:

- the relief of financial hardship;
- the advancement of education;

- the advancement of religion; and
- certain other purposes for the benefit of the community.

For the most part, the Canadian provinces and territories have not defined "charity" or "charitable purposes" in legislation but - similar to the federal approach - have left it to the courts to apply common law. However, in some jurisdictions there are statutory definitions, which, to varying degrees, expand or modify the common law definition.<sup>[6]</sup> Finally, it should be noted that, in the case of other organizations that comprise the grouping "qualified donees" (apart from registered charities), public benefit is not a requirement.

## V. Specific Questions Regarding Local Law

### A. Inurement

The Income Tax Act, in defining NPOs contains the following provision:

" 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" [[Paragraph 149\(1\)\(l\), The Income Tax Act](#)].

Similarly, the Income Tax Act, in defining charities, contains the following provision:

"no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof" [Subsection 149.1(1), the Income Tax Act].

This is interpreted to mean that no dividend or similar payment or a liquidating distribution can be made for the personal benefit of individuals, etc. It does not preclude, however, members or others being paid for services actually rendered.<sup>[7]</sup> These requirements, specified in law and practice, are generally consistent with U.S. prohibitions on private inurement.

### B. Proprietary Interest

In the case of an NPO, members may have a proprietary interest and may, for example, be entitled to a return of contributed capital upon retirement as a member or upon the dissolution of the organization.

In the case of a charity, no proprietary interest is possible, and the legislative framework

precludes a member from receiving any assets, whether out of income or capital. Indeed, if such a transfer took place, the Income Tax Act imposes at least 100% tax on the amount so paid [[Subsection 188.1\(4\), Income Tax Act](#)].

## C. Dissolution

The dissolution of a corporation is governed by the applicable federal, provincial, or territorial law under which it was set up. In the case of a trust, the dissolution would be governed by the trust deed or, if the deed were silent on the subject, might require the intervention of a court.

In practical terms, aside from the legal procedures, the key element remains the federal Income Tax Act. For NPOs, there are statutory rules that deal with the conversion of such an organization into a taxable entity, including the winding up and distribution of assets to members. When this occurs, the law requires that the organization's tax-free status be terminated, deeming a disposition of all the assets for tax purposes, and taxing the recipients of any money or assets.

On the other hand, to be registered as a charity, there must be a clause in the incorporating documents or by-laws that states that upon winding up (or a loss of registered status) all the assets must go to another qualified donee. If this is not done, there would be a 100% tax on recipients of any assets [[Subsection 149\(10\)](#) and [Subsection 188\(1\)](#), The Income Tax Act].

## D. Activities

### 1. General

As discussed above, an NPO can be set up for any purpose other than profit. In practice, this means that almost any sort of activity can be a legitimate purpose. Indeed, the Income Tax Act does not require registration of these organizations, and they self-assess their own status.

In the case of registered charities, they are limited to activities which are charitable at common law, namely the relief of poverty, the advancement of education, the advancement of religion, or "such other purposes which are beneficial to the community" as recognized by case law [[See 3 T.C. 53, \(1891\) A.C. 53, \(1891-94\) All E.R. Rep. 28 H.L. and the CRA's Registering a Charity for Income Tax Purposes T4063](#)].

The act also deems certain activities to be charitable, including the transfer of funds to a qualified donee, the carrying on of a related business and, within very strict limits, "political activity." These issues are discussed below.

### 2. Economic Activities

NPOs, by definition, cannot carry out any activity for profit. However, it is quite clear that they can engage in a range of activities that generate revenue and, indeed, may generate a profit if it is clear that this is not a purpose of the organization.

Registered charities (other than private foundations) are allowed to carry out "related business activities" [[Paragraph 149.1\(6\), Income Tax Act](#)]. This term is undefined. As a practical matter, the first time a case came before the courts, a two-to-one majority held that any activity was a related business if the profits were used in charitable activities of the organization. This case was later distinguished by the same court and it seems fair to say that the "destination test" will no longer apply in determining what is a related business.

## **E. Political Activities**

NPOs have no limits on political activities and indeed, political parties are a sub-category of the NPO category of organizations (as they are in the US).

Charities pose a more complex case. The Income Tax Act seeks to limit political activity, requiring that those activities are "ancillary and incidental" to the organization's charitable activities, and "do not include the direct or indirect support of, or opposition to, any political party or candidate for public office" [[Paragraph 149.1\(6.2\), Income Tax Act](#)]. While this latter limitation would seem to meet the U.S. ban on "electioneering" activities by qualified donees, the lack of guidance with respect to what is "political" under Canadian law may pose some issues for U.S. donors.

In addition, the courts in Canada have consistently expanded the notion of what is meant by the term "political activities," and it now seems that one is hard pressed to distinguish between education, advocacy, and political statements. The Canada Revenue Agency has issued a paper, CPS 022, which attempts to explain its view of these issues.

## **F. Racial Discrimination**

There is a great deal of legislation to combat racial discrimination and the promotion of racial hatred in Canada, and the courts have not been hesitant to apply this legislation to NPOs. In case after case, the courts, bolstered by legislation, have tried to ensure that any form of discrimination in the field of charities and NPOs is barred. (See for example *Canada Trust v. Ontario Human Rights Commission* 74 OR (2d) 481; 69 DLR (4th) 321; *Gould v. Yukon Order of Pioneers* [1996] 1 SCR 571; re *Ramsden Estate* 139 DLR (4th) 746.)

That said, the tax authorities also have the legislative power to recognize foreign universities as being the equivalent, for tax purposes, of a Canadian registered charity. Because the statutory test is simply that the institution "usually" has Canadian students and that it is accredited in its own jurisdiction, it is possible that some such universities might practice some forms of discrimination. A full list of such institutions will be found in Schedule VIII of the Income Tax Act.

## **G. Control of Organizations**

No restriction exists on the control of Canadian not-for-profit organizations by other organizations or persons. For public foundations, which are formed by a government entity, control is exercised by such entity. With respect to other organizations, it is possible that a Canadian association or foundation may be controlled by a for-profit entity that establishes it, even though it does not own it (which will lead to additional IRS scrutiny). The same would be true for a Canadian association or foundation controlled but not owned by an American grantor charity (which requires that the charity specifically so provide in the affidavit).

## **VI. Tax Laws**

The following section discusses relevant tax legislation, recognizing that taxes may affect the amount of the grant actually flowing to the donee.

### **A. Tax Exemptions**

Neither NPOs nor registered charities are subject to any taxes on income.<sup>[8]</sup> Nor are there taxes on any activities falling outside of an organization's statutory powers. That is to say, if an NPO actually turns out to have a profit motive, then it loses its NPO status and is treated as an ordinary taxable entity.

Similarly, a registered charity is not subject to income tax. Any breach of the statutory rules might lead to a revocation of its registration. However recently enacted legislation does create a series of potential fines for breach of the rules and such breaches may also lead to a temporary suspension of the privilege of issuing receipts. As this is written, only two charities have been subject to these rules, but it is likely that more will be penalized. A list of charities which have had their privileges suspended will be found on the CRA web site.

### **B. Tax Treatment of Donations**

The main and vital distinction for practical purposes between NPOs and charities (and other qualified donees) is that gifts to the former cannot qualify for tax relief for donations, while gifts to the latter may.<sup>[9]</sup> The Canadian system relies on a tax credit (as opposed to deduction) system to give tax relief to individuals, while corporate donors receive tax benefits through the conventional deduction system. The rules are fairly complicated, and details - which are particularly relevant to grantmakers with entities established in Canada - can be found in Revenue Canada's guide entitled, "Tax Advantages of Donating to Charity." See <http://www.cra-arc.gc.ca/tx/chrts/dnrs/svngs/menu-eng.html>

In addition, it should be noted that Canada does not have gift taxes. Moreover, there are no death duties per se, though there may be a deemed disposition of capital property on death.

## C. Sales Taxes

Charities and NPOs are generally part of the federal and provincial sales tax regimes and though they may have some special rules based on specific activities, there is no general exemption available. That said, the federal Goods and Services Tax does have a special feature. Once an organization has calculated its net tax liability if any (GST collected net of input tax credits), if it is either a registered charity or a NPO which receives 40% of its funding from one or more levels of government, it is entitled to receive a rebate of one-half the net tax paid.<sup>[10]</sup> Moreover, there is no GST due on foreign grants.

On July 1, 2010 Ontario and British Columbia will adopt a “harmonized” sales tax (HST) whereby existing provincial sales taxes will be linked to the federal GST as a single levy. Charities and non-profits in those provinces will have identical treatment under the HST as they did under the GST.

## D. Tax Conventions

The United States and Canada have entered into a tax treaty that addresses cross-border donations. Specifically, the tax treaty permits charitable deductions for contributions made to Canadian charities if certain requirements are met. The most important part of the tax treaty rules is that the deduction may not exceed the amount of the donor's Canadian source income, which significantly diminishes the utility of this provision to many U.S. grantmakers. Moreover, under IRS Notice 99-47, I.R.B., 1996-36, page 344, all Canadian registered charities are deemed to be the equivalent of a tax-exempt organization under the Internal Revenue Code. Unfortunately, the Notice does not address whether private foundations may rely on this equivalency, so prudence suggests that U.S. grantmakers still undertake equivalency determinations. For a detailed discussion of this tax treaty, please see Appendix II of Beyond our Borders.

## VII. List of Knowledgeable Contacts

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## Footnotes

[1] The Canada Corporations Act has been substantially revised in legislation passed in 2009. While the legislation has been passed, it has not been “proclaimed” and thus is not in force. It is likely to be proclaimed in 2010 or 2011. When this happens, every corporation created under the “old” act will be required to revise its letters, patent and by-laws to conform with the new statutory provisions. It is understood that there will be a three year period after proclamation for this to be done.

In May 2010, Ontario introduced legislation to revise its laws relating to non-share corporations which is similar in many respects to the new federal legislation. We would expect that there might be a several year transition period from the date the legislation is actually enacted.

[2] This post-September 11 legislation deals with direct and indirect financing of terrorism by charities. Interestingly, however, this legislation does not cover NPOs.

[3] Notably, the Charitable Gifts Act of Ontario was repealed in late 2009 after being law for more than seven decades.

[4] Each province and territory has its own income tax act, but in the area of NPOs and charities, almost all precisely mirror federal legislation. Only Quebec has a separate registration regime for charities, but that registration is functionally automatic when evidence of federal registration is presented.

[5] A legislative change which eliminates a contribution test has not as yet been passed but the CRA is administering the law as though it has been enacted. The test would require that “not more than 50% of the funds that the charity has received have come from one person or organization, or from a group of people or organizations that do not deal with each other at arm’s length.”

[6] In Alberta, the Charitable Fund-Raising Act extends the common law by defining "charitable purpose" as including "a philanthropic, benevolent, educational, health, humane, religious, cultural, artistic or recreational purpose, so long as the purpose is not part of a business." Similarly, in Manitoba the Charities Endorsement Act defines "charitable purpose" as including "any charitable, benevolent, philanthropic, patriotic, athletic, artistic, or civic purpose that has as its object the promotion of a civic improvement or the provision of a public service."

[7] Ontario, following its interpretation of common law, takes the position that no payment can be made to a director or trustee of a charity, even if actual work is performed for the organization.

[8] There is in fact one small exception. Where a non-profit organization is set up to provide "dining, recreational or sporting facilities" to its members, it is subject to tax on any passive investment income it might earn in excess of \$2,000.

[9] Of course, payments made to an NPO may qualify for tax relief as business deductions in appropriate cases. Thus, lawyers would normally be able to deduct the fees they pay to the Canadian Bar Association (a non-profit) if the lawyer is practicing.

[10] While for most organizations this may be a relatively small concession for being in the system, it is hugely valuable when major purchases are made or when a building is being constructed. Indeed, many organizations which might not otherwise wish to be registered as a charity do so in order to qualify for GST rebates.