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CHARITIES AND NOT-FOR-PROFIT NEWSLETTER

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The Charities and Not-for-Profit Newsletter is published monthly by Miller Thomson LLP's Charities and Not-for-Profit Group as a service to our clients and the broader voluntary sector. We encourage you to forward the e-mail delivering this newsletter to anyone (internal or external to your organization) who might be interested. Complimentary e-mail subscriptions are available by contacting charitieseditor@millerthomson.com.

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ONTARIO GOVERNMENT PASSES GOOD GOVERNMENT ACT THAT INCLUDES POSITIVE CHANGES FOR CHARITIES

Kate Lazier
Toronto
416.595.8197
klazier@millerthomson.com

and

Susan M. Manwaring
Toronto
416.595.8583
smanwaring@millerthomson.com

On December 15, 2009, the *Good Government Act 2009* (Ontario) came into effect. This statute updates the law as it apply to charities that operate in Ontario and levels the playing field for charities operating in Ontario to be consistent with charities operating in other provinces in Canada.

More particularly the changes include the following:

1. The statute has repealed the *Charitable Gifts Act*. The *Charitable Gifts Act* was particularly problematic in that it restricted charities from directly or indirectly owning more than a 10% interest in a business. This rule was quite broadly worded and the language of the statute led to more questions than answers about what it meant for a charity to own a 10% interest in a business. The restriction was outdated and submissions to the Ontario Government had been made for a number of years suggesting that this statute should be repealed. This step is welcome and the government should be applauded for repealing this law.

   The repeal of this statute does not mean that charities can now, without thought, set up for-profit companies and/or pursue business activities. There remain issues to be addressed under the *Income Tax Act* (Canada) which are relevant to this question. The repeal removes one hurdle but the others still need to be carefully considered.

   The statute as passed added section 14 to the *Charities Accounting Act*. This new section "cures" breaches of the *Charitable Gifts Act* that occurred prior to the *Charitable Gifts Act* being repealed.

2. The *Good Governance Act, 2009* amended the *Charities Accounting Act* as a consequence of the repeal of the *Charitable Gifts Act*. In particular, the *Charities Accounting Act* will now contain provisions which will permit the Public Guardian and Trustee of Ontario to make inquiries and require information or documents respecting entities in which an executor or trustee holds a substantial interest. The phrase "executors or trustees" includes directors of any charitable corporation as the *Charities Accounting Act* defines those individuals to be trustees for the purpose of its administration. These provisions will allow the Public Guardian and Trustee to ask questions about business interests held by charities. The new legislation provides that the Public Guardian and Trustee can ask for the business records of the entity, information

respecting the assets and liabilities of the entity, accounts of income and expenses for the entity, financial statements of the entity and the particulars of any fees, salary or other remuneration paid to any person by the entity.

The determination of what constitutes a substantial interest is very similar to the determination used by the *Income Tax Act* for the excess business holdings rules. If the executor or trustee beneficially owns, controls or has direction, either directly or through another entity, over more than 20% of the voting rights, or 20% of the assets of the entity, the Public Guardian and Trustee will be permitted to inquire for the information listed in the section.

Section 4.1 of the *Charities Accounting Act* will provide that a court will be permitted to make certain orders in the event of application made by the Public Guardian and Trustee after reviewing the information provided. The types of orders that the court may make relate to the management, operation, ownership or control of the entity and are tied to ensuring that the entity is operating in the best interests of the charitable purpose for which the estate or trust is held. Section 4.1 also provides that anyone who contravenes the section is guilty of an offence and can be liable to a fine not exceeding $25,000.

It should be noted that this provision requires proactive requests for information to be made by the Public Guardian and Trustee. There is no annual requirement to file information about an entity respecting this information where the estate or trust has a substantial interest. Rather the Act provides the Public Guardian and Trustee with additional tools to obtain information relating to any business in which the charity or estate has a substantial interest. It would be expected that the Public Guardian and Trustee would rely on these rules in situations where it comes to its attention that there is a concern regarding the entity.

3. A second amendment to the *Charities Accounting Act* relates to interests in real or personal property held for a charitable purpose. Historically, the *Charities Accounting Act* restricted the holding of land by a charity and provided that it could only be held to the extent that it was used for the charitable purposes. That was interpreted to mean that the charity could not own excess land and lease it out. The section is now reworded and no longer provides for vesting in the Public Guardian and Trustee if there is excess property held. The proposed section provides that a charity that holds an interest in real or personal property shall use the property to benefit the charitable purposes.

   As reworded, the section remains somewhat unclear. However, the government officials have stated that the amended section is intended to be relieving and that excess real or personal property that is not directly used in the charitable activity can remain in the charity and can be invested in accordance with prudent investor standards of the *Trustee Act*.

4. The *Accumulations Act* has been amended to clarify that the rules of law and statutory enactments relating to accumulations do not apply and are deemed never to have applied to charitable trusts. This resolves a somewhat technical concern relevant to longstanding charitable trusts.

New legislation, when released, often brings with it questions and comments. It is undoubtedly true that there will be some requests for clarification on the new legislation. However, as a general proposition, these changes are relieving and helpful for the charitable sector and are changes which the Ontario Bar Association, Charities and Not-for-Profit Section has been discussing with the office of the Public Guardian and Trustee for a number of years. These changes should be well-received and will permit greater flexibility to charities when structuring revenue-generating activities in the future.

UNINCORPORATED RELIGIOUS ORGANIZATIONS AND LEASES

Michael J. Wren
Toronto
416.595.8184
mwren@millerthomson.com

and

F. Max E. Maréchaux
Toronto
416.595.8522
mmarechaux@millerthomson.com

On December 3rd, 2009, the Ontario legislature gave third reading to Bill 212 and then passed the Bill, now known as the *Good Government Act 2009*. The existing Provincial legislation affected by the passing of Bill 212 includes the *Religious Organizations' Lands Act*, R.S.O. 1990, Ch. R. 23 ("ROLA"). The provisions of ROLA apply to unincorporated religious organizations and prescribe, in part, the manner in which trustees may acquire, hold and alienate interests in real property on behalf of an unincorporated religious organization. Prior to the passing of the Bill 212, the trustees of an unincorporated religious organization had the power to lease lands not required for the religious purposes of the organization, but ROLA limited the aggregate term of any lease granted by trustees, inclusive of all renewals, to a period not to exceed forty (40) years. One of the effects of Bill 212 is to amend ROLA to eliminate the forty (40) year restriction on leases. Effectively, at least as far as leases of real property are concerned, Bill 212 has placed unincorporated religious organizations and congregations on the same footing as incorporated churches or faith groups. The Ontario Court of Appeal had held many years ago in *Re Incorporated Synod of the Diocese of Toronto and H.E.C. Hotels Ltd. et al*, that the provisions of ROLA have no application to an incorporated religious body.

CHARITIES, DONATION REQUESTS & ANTI-SPAM: THE EFFECTS OF BILL C-27

Roxanne Chow
Toronto
416.595.2649
rchow@millerthomson.com

Email and other types of electronic communication provide their users with very cost-effective ways to reach out to a wide audience, and as anyone with an email account can tell you, this can result in copious quantities of unwanted emails or spam. Bill C-27, also known as the *Electronic Commerce Protection Act* (the "ECPA"), was introduced in order to address this problem and it has just passed first reading in the Senate. As the ECPA will apply to anyone who sends electronic communication, it is advisable for charitable and non-profit organizations to review their privacy policies and their electronic communication practices to ensure that they are aligned with the provisions of the ECPA, and to take advantage of the exemptions set out in the ECPA for charities and those engaged in non-commercial activities. This article provides a general overview of what the ECPA will entail.

Application

The ECPA applies to electronic messages. An electronic message refers to a message sent by any means of telecommunication, including a text, sound, voice or image. An electronic address refers to an email account, an instant messaging account, a telephone account or any similar account. More specifically, the ECPA seeks to regulate commercial electronic messages. A commercial electronic message includes a message sent to an electronic address that:

- promotes, advertises or offers to purchase, sell, barter or lease a product, good, service, land or an interest or right in land;
- promotes, advertises or offers to provide a business, investment or gaming opportunity; or
- promotes a person as being a person who does, or intends to do, anything referred to above.

Implicit and Explicit Consent to the Receipt of Commercial Electronic Messages

Under section 6 of the ECPA, a person cannot send an electronic message without the recipient's prior consent. Consent is implied where there is an existing business or non-business relationship between the sender and the recipient of the message. Of particular interest for non-profit organizations is the term, "existing non-business relationship", which is defined as a non-business relationship between the sender and the recipient and within the two-year period preceding the date on which the message was sent:

- where a registered charity is the sender - the recipient had made a donation the sender, or had performed volunteer work for the sender.
- where the sender is a club, association or voluntary organization as defined in the ECPA regulations - the recipient was a member of the sender.

If the sender does not have an existing relationship with the recipient, the sender must obtain the *express consent* of the recipient prior to sending the electronic message by setting out clearly and simply:

- the purpose for which the consent is being sought;
- the information that identifies the person seeking consent or, if applicable, the person on whose behalf the consent is being sought; and
- any other information set out in the ECPA regulations.

Content of Electronic Messages

Regardless of whether the consent obtained is expressed or implied, the ECPA requires the sender to set out the following information in any unsolicited commercial electronic message and provide a mechanism that allows the recipient of the message to "unsubscribe" or withdraw his or her consent to receive further messages from the sender:

- information that identifies the sender of the message or, if applicable, the identity of the person on whose behalf the message is sent; and
- the contact information of the sender that is valid for at least 60 days.

The unsubscribe mechanism can operate through the same electronic means by which the message was sent, but otherwise the message must contain an electronic address or hyperlink by which the recipient’s unsubscribe request can be submitted. In addition, each unsubscribe request received by a sender must be put into effect no later than 10 business days after the request was sent.

Collection of Personal Information

The ECPA also amends the *Personal Information Protection and Electronic Documents Act* (PIPEDA) by requiring that the sender obtain the consent of the recipient to collect and use the recipient’s personal information through any means of telecommunication, if the collection is made by accessing a computer system without the recipient’s authorization. For more information on how PIPEDA applies to charities and non-profits see our January 2005 and November 2006 newsletters.

Penalties

The maximum fine for a violation of the ECPA prohibitions is $1 million in the case of an individual, and $10 million in the case of any other person (i.e. an organization). However, violators of ECPA may also have to pay for loss or damage suffered by each individual who claims a private right of action under the ECPA prohibition on commercial electronic messages sent to them without their consent. Under a private right of action, the court may issue an order requiring the violator to pay compensation to each such recipient up to a maximum of $200 for each contravention, and up to $1 million for each day on which any contravention occurred.

Exceptions

Certain electronic messages are exempt from the ECPA prohibition, including:

- a message sent by an individual to a recipient with whom he or she has a personal or family relationship;
- a message that provides notification of factual information about the ongoing subscription, membership,

or account of the person to whom the message is sent, or the use or purchase by a person to whom the message is sent about a product, good or service offered under a subscription, membership or account by the person who sent the message;

- an interactive two-way voice communication between individuals;
- a fax sent to a telephone account;
- a voice recording sent to a telephone account; and
- a message that is sent in circumstances that will be specified in the ECPA regulations (the ECPA regulations have not been developed at this time).

Conclusion

The ECPA requires that recipients provide consent for the receipt of electronic messages from the sender. In addition to obtaining consent, the sender must provide full disclosure of the intent or purpose of procuring the recipient's electronic address, and inform the recipient that he or she can opt out of receiving information from the sender at any time. The sender must therefore have an opt-out or unsubscribe mechanism in place prior to sending electronic messages.

For the most part, these types of activities should be quite familiar to organizations with privacy practices. However, it is worthwhile to review of your organization's practices and policies with respect to communications, compiling donor lists, volunteer lists, and protecting personal information to prevent inadvertent breaches of the ECPA when it comes into effect.

THE CANADA REVENUE AGENCY'S VIEWS ON 149(1)(L) NON-PROFIT ORGANIZATIONS

Susan M. Manwaring
Toronto
416.595.8583
smanwaring@millerthomson.com

A recently released technical interpretation (document # 2009-0337311E5) has given rise to concerns that the Canada Revenue Agency ("CRA") may be altering its administrative policies with respect to how organizations that are established with the intention of qualifying as a 149(1)(l) tax exempt non-profit organization can operate.

By way of background technical interpretations are responses written by CRA rulings to authors who send a letter asking a list of hypothetical questions. The author generally will set out certain facts and questions and CRA responds. CRA makes it clear that it does not respond in a binding way to a specific fact situation and these technical interpretations are designed to assist Canadians in a general way to understand how CRA administers the *Income Tax Act* (the "Act").

Paragraph 149(1)(l) of the Act provides an exemption from income tax for the income of

> ...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; (emphasis added)

A summary of the questions asked and the answers given by CRA in this technical interpretation follows below:

Question (i) - Can an organization that qualifies for an exemption from tax under paragraph 149(1)(l) of the Act compete against taxable entities?

CRA's answer - Yes. Technically, a non-profit entity could compete against a taxable entity. The only requirement to be met (relying on the *BBM Canada* case quoted below) is that the non-profit entity cannot have a for profit purpose.

Question (ii) - Can an organization earn a profit and continue to be exempt from tax under paragraph 149(1)(l) of the Act? Can an organization intentionally earn a profit, and still be exempt from tax under 149(1)(l), as long as that profit is used solely for the purpose of supporting its objectives?

CRA's answer - It is not the fact that an organization earns a profit that causes it to go offside – it is the intentionality of earning a profit. In other words if the organization accidentally earns a profit it is fine but if the profit is intentional (i.e. to save for a rainy day), that will cause the entity to be considered taxable. The letter references the words "operated exclusively….for any other purpose except profit" and suggests it means that a non-profit entity can never intend to make a profit and qualify as tax exempt under the section. This is the case even it plans to use the profit for its non-profit purposes (i.e. the rulings officer rejected the destination of funds test yet again).

The response goes further in that it suggests that earning a surplus to put money aside for capital projects of an organization is an indicator of a profit purpose and an organization that does this will not qualify for the tax exemption. CRA recognizes that it may be appropriate to have a rainy day fund for operating expenses, but clearly suggests that the only reserves for future capital projects should be those that are derived from member revenues not other income-generating activity of the organization.

Question (iii) - Is it possible for an organization to incorporate under Part III of the *Ontario Corporations Act*, but not qualify for the exemption from tax provided under paragraph 149(1)(l) of the Act?

CRA's answer – Yes. CRA is clearly of the view it is possible for an organization to meet the requirements of federal or provincial "not-for-profit" incorporation legislation, but not qualify for the tax exemption provided under paragraph 149(1)(l) of the Act. This is because most corporate legislation does not contain language that suggests the entity must be operated exclusively for a purpose other than profit.

Question (iv) - Does the Canada Revenue Agency ("CRA") maintain a list of organizations that qualify as non-profit organizations for purposes of provincial legislation, but do not qualify for the tax exemption provided under paragraph 149(1)(l) of the Act?

CRA's answer – No. The CRA does not maintain a list of organizations that qualify for the exemption provided by paragraph 149(1)(l) of the Act. Unlike charities, these organizations are not required by the Act to register with the CRA.

Question (v) - The recent Tax Court of Canada decision, *BBM Canada v. The Queen*, 2008 DTC 4129 ("BBM Canada") concluded that an entity described in paragraph 149(1)(l) of the Act may conduct commercial activity but must conduct this activity at cost. If [an entity] provided a commercial procurement contract to an organization, and the organization generated a profit from this activity, would the organization be able to qualify for the tax exemption provided under paragraph 149(1)(l) of the Act?

CRA's answer - CRA indicated that the answer to this question would be based on the particular facts of the situation, but commented further that if the fee provided for in the contract included a markup – that it would be indicative of a profit purpose and thus the organization could be offside.

A review of the answers provided by CRA explains why the letter raises concerns among those entities that are currently operating as non-profit organizations and those who practise in this area. A number of long standing non-profit entities have worked to incorporate sound practices to ensure financial viability over the long-term. This has included embarking on capital projects to support their operations and operating to ensure deficits are avoided. Financial stability of any entity, whether operating as a for-profit or non-profit entity, should be applauded. In fact, one would have thought these standards are a requirement in today's world of increasing transparency and accountability to shareholders, members and the community at large.

The unfortunate reality is that this exemption from tax on income applies to a broad array of operating organizations, many of which function consistently with these statements and many of which do not. Historically, CRA has left organizations operating as non-profits pretty much to themselves. If CRA intends to change its approach and renew interest in the operations of paragraph 149(1)(l) entities it should in our view update

Interpretation Bulletin IT-496R to reflect the current operating reality of non-profits and work to educate that sector prior to embarking on a formal audit initiative or review.

In short, this author hopes that the responses in this technical interpretation are not indicative of a new quite restrictive administrative approach by CRA.

FEDERAL COURT OF APPEAL CONFIRMS TRANSFERS OF NON-QUALIFYING SECURITIES

Andrew Valentine
Toronto
416.595.2980
avalentine@millerthomson.com

On November 19, 2009, the Federal Court of Appeal upheld the decision of the Tax Court of Canada in *Frank Remai (Estate of) v. The Queen*. The case concerned whether a taxpayer was prevented from claiming donation tax credits in respect of a gift of certain debt obligations which were then transferred from a controlled foundation to another corporation. The Federal Court of Appeal upheld the Tax Court's decision that the transfers were acceptable.

We reported on the Tax Court decision in the October 2008 issue of the Miller Thomson Charities Newsletter. The facts of the case, in brief, are that the donor, Mr. Remai, gifted certain interest-bearing promissory notes to a foundation controlled by him. Because the notes had been issued by a corporation (FRM) related to Mr. Remai, he could not claim a donation tax credit for the gift (as a result of the anti-avoidance rules in the *Income Tax Act* related to non-qualifying securities ("NQS") which prevent taxpayers from recognizing gifts of securities from non-arm's length companies). However, Mr. Remai sought to take advantage of a provision which allows recognition of the gift if the donee (i.e. the Foundation in this case) disposes of the NQS within 5 years of the original gift. After considering various options, Mr. Remai arranged for the purchase of the notes by a corporation, Sweet Developments Inc. ("Sweet"), controlled by his nephew. Sweet purchased the notes in exchange for identical promissory notes from Sweet in favour of the Foundation.

CRA had challenged the transaction on the basis that the donor and Sweet were not dealing at arm's length, and that the transaction was, in any event, an avoidance transaction in violation of the general anti-avoidance rule ("GAAR").

For a unanimous Court, Evans J.A. upheld the Tax Court's conclusion that the donor and Sweet were operating at arm's length. Although Evans J.A. acknowledged that Mr. Remai was the driving force behind the proposed transaction, he concluded that Mr. Remai did not control Sweet. Evans J.A. was also satisfied that Sweet was pursuing its own separate interests in the transaction. In particular, he noted that Sweet was at risk to the extent that FRM (which had originally issued the notes to Mr. Remai) might be unable to honour the notes, and was therefore willing to purchase the notes only after investigating FRM's ability to repay. This overcame a key difficulty with NQS – namely, the difficulty of determining their fair market value. Because the notes' value ultimately depends on the ability of the issuer to honour them, the purchase price that Sweet was willing to pay enabled a determination of the fair market value of the notes, which thus allowed the notes to be receipted at that value.

Evans J.A.'s conclusion regarding valuation also enabled him to conclude that GAAR did not apply to prevent Mr. Remai from claiming the tax credits. He stated that one of the purposes of the NQS provisions was to disallow charitable tax credits in respect of certain gifts whose fair market value is difficult to determine because of the non-arm's length nature of the transaction. The provisions, however, clearly permit a taxpayer to claim a credit where recipient charity disposes of the NQS to a third party in an arm's length transaction. Evans J.A. rejected CRA's contention that the purpose of the NQS provisions is to disallow tax credits for charitable gifts where the donor retains control of the capital of the gift. Evans J.A. held that this latter situation is covered by the loan-back provisions in the *Income Tax Act*, which did not apply.

As we noted in October 2008 regarding the Tax Court decision, this decision confirms that donors may avail themselves of the redemptive provisions in the NQS rules even if the sole purpose of the redemptive transactions is to allow for the tax benefit. It also confirms the centrality of the valuation issue in the NQS rules – where this can be resolved through an arm's length transfer of the securities by the charity that received the gift of NQS, the donor will be able to claim tax credits for the gift.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

Lou Milrad was honoured as a Local Hero at the Local Heroes Building Bridges Gala by ORT Toronto for his outstanding leadership and contribution to the education of children and adults locally, nationally and worldwide on November 18, 2009.

Susan Manwaring presented the "Rethinking Investment Approaches" event for the Community Foundations of Canada at the Munk Centre, University of Toronto and MaRS Discovery District on December 2, 2009.

Kate Lazier and **Susan Manwaring** wrote "Good Government Act Heralds Positive Changes for Charities" in the December 4, 2009 issue of *The Lawyer's Weekly*.

Arthur Drache chaired a Board meeting for the International Center for Not-for-Profit law in Washington, D.C. on December 14, 2009.

Kate Lazier and **Susan Manwaring** wrote "Ontario Government Releases Good Government Bill That Includes Positive Changes for Charities" in the December 2009 issue of *Charitable Thoughts* published by the Ontario Bar Association.

MILLER THOMSON LLP CHARITIES & NOT-FOR-PROFIT GROUP

Toronto/Markham

Rachel L. Blumenfeld	416.596.2105
Donald Carr, Q.C., O.Ont., L.H.D	416.595.8506
Kelly A. Charlebois	416.595.2632
Arthur B.C. Drache, Q.C., C.M.	416.595.8681
Mark R. Frederick	416.595.8175
Kathryn M. Frelick	416.595.2979
Robert J. Fuller, Q.C.	416.595.8514
Lorelei Graham	416.595.8513
Robert B. Hayhoe	416.595.8174
Hugh M. Kelly, Q.C.	416.595.8176
Michael W. Kerr	416.595.8620
Kate Lazier	416.595.8197
Susan M. Manwaring	416.595.8583
Rosanne T. Rocchi	416.595.8532
Martin J. Rochwerg	416.596.2116
Amanda J. Stacey	416.595.8169
Brenda Taylor (Corp. Services)	905.415.6739
Andrew Valentine	416.595.2980
Michael J. Wren	416.595.8184

Vancouver

Kenneth N. Burnett	604.643.1203
Sandra L. Enticknap	604.643.1292
Alan A. Hobkirk	604.643.1218
Eve C. Munro	604.643.1262
Cheryl M. Teron	604.643.1286

Calgary

Esmail Bharwani	403.298.2418
Gail P. Black	403.298.2410
Gerald D. Chipeur, Q.C.	403.298.2434
William J. Fowlis	403.298.2413
Connie L. Hykaway	403.298.2463
Gregory P. Shannon	403.298.2482

Edmonton

Wendi P. Crowe	780.429.9764
David R. McCalla	780.429.9752
Dragana Sanchez Glowicki	780.429.9703

London

Kristina M. Shaw	519.931.3511

Kitchener-Waterloo

Stephen R. Cameron	519.593.3207
John J. Griggs	519.593.3231
J. Jamieson K. Martin	519.593.3247
Richard G. Meunier, Q.C.	519.593.3251

Guelph

Robin-Lee A. Norris	519.780.4638

Montréal

Ronald Auclair	514.871.5477
Richard Fontaine	514.871.5496
Louise Tremblay	514.871.5476