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Policy Forum: Using Dual Structures for Political Activities—Charities and Non-Profits in the Same Family of Organizations

Robert B. Hayhoe and Nicole K. D'Aoust*

PRÉCIS

Les règles contenues dans la Loi de l'impôt sur le revenu et la politique suivie par l'Agence du revenu du Canada limitent le montant et le type d'activités politiques que peuvent exercer les organismes de bienfaisance enregistrés. Puisque les organismes à but non lucratif ne sont pas assujettis à ces règles, il est bien connu que ces organismes utilisent des structures doubles pour mener une activité politique. Au cours des dernières années, l'ARC a vérifié les activités politiques des organismes de bienfaisance, et même si le programme de vérification est progressivement réduit, de nombreux organismes de bienfaisance s'inquiètent de ces vérifications à cause des coûts élevés associés à leur contestation et du risque de perdre leur statut d'organisme de bienfaisance.

Cet article traite de la manière dont ces structures doubles sont mises en œuvre, et des questions de conformité qu'il faut se poser dans ce genre de planification. Les commentaires des auteurs s'appuient principalement sur l'expérience des échanges avec l'ARC : le gouvernement a publié peu de documents et il existe peu de jurisprudence sur cet aspect. Récemment, un groupe d'experts nommés par la ministre du Revenu national a préparé un rapport à l'intention de la ministre contenant des recommandations sur la façon de clarifier et d'étendre peut-être la capacité des organismes de bienfaisance enregistrés à mener une activité politique. L'ARC devrait commenter le rapport au cours des prochains mois. On s'attend à ce que les organismes de bienfaisance continuent d'utiliser des structures doubles pour mener une activité politique dans un avenir rapproché, puisque ce type de planification offre divers avantages.

ABSTRACT

The rules in the Income Tax Act and in Canada Revenue Agency (CRA) policy limit the amount and type of political activity that registered charities are permitted to carry on. Since non-profits are not subject to these rules, organizations are known to use dual

* Robert B. Hayhoe (e-mail: rhayhoe@millerthomson.com) and Nicole K. D'Aoust (e-mail: ndaoust@millerthomson.com) are with Miller Thomson LLP, Toronto.

structures to carry on political activity. In the past few years, the CRA has audited charities for their political activities, and although the audit program is being wound down, many charities remain concerned about these audits because of the significant costs involved in defending them and the risk of losing their charitable status.

This article describes how dual structures are implemented, as well as the compliance issues that need to be considered for this type of planning. The authors' comments are based primarily on experience dealing with the CRA: few government documents have been published in this area, and there is little case law. Recently, a panel of experts appointed by the minister of national revenue prepared a report for the minister with recommendations on how to clarify and potentially broaden the ability of registered charities to carry on political activity. The CRA is expected to comment on the report in the coming months. It is expected that charities will continue to use dual structures to carry on political activity for the foreseeable future, since this type of planning offers various advantages.

KEYWORDS: CANADA REVENUE AGENCY ■ CHARITIES ■ NON-PROFIT ORGANIZATIONS ■ POLICY ■ POLITICAL ■ STRUCTURES

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INTRODUCTION

Generally speaking, Canadian registered charities are permitted to carry on political activity only within a range of 10 percent of their overall resources. However, non-profits are not subject to the limits on political activity that apply to charities.[1] Thus, charities and non-profits have traditionally been used together in the same family of organizations to carry on such activity. Depending on the particular circumstances, non-profits can be used to carry on political activity either in excess of what the 10-percent rule allows or for all of the political activities that are contemplated. Charitable advocacy that is not political can remain in the charity if desired.

1 The basic rules in subsections 149.1(6.1) and (6.2) of the Income Tax Act, infra note 4, provide that a charity may carry on political activity if "substantially all" of the charity's resources are devoted to charitable purposes. The CRA has generally interpreted "substantially all" to mean 90 percent or more of the charity's resources. Partisan political activity is strictly prohibited. See Canada Revenue Agency (CRA) *Charities Policy Statement* CPS-022, "Political Activities," September 2, 2003. For a detailed discussion of the political activity rules, see Robert B. Hayhoe and Nicole K. D'Aoust, "Canadian Charities and the Rules on Political Activity," in *Charity Law: What's New and Emerging?* (Toronto: Ontario Bar Association, February 4, 2015).

Given that a charity is permitted to carry on a modest amount of political activity, practitioners in the past have sometimes wondered whether the use of non-profits for such activity would continue to be relevant. Since at least 2012, however, when the minister of finance[2] and the Canada Revenue Agency (CRA) announced that the CRA would be devoting significant resources to auditing charities for political activity, the use of non-profits for this purpose has become steadily more important to charities. Although advocacy charities know that the CRA's audit program is being wound down,[3] charities remain very mindful of the rules on political activity in the Income Tax Act.[4] This awareness is owing to the costs and the serious consequences that some charities have incurred, including the revocation of their charitable status, through the audit program.

It is important to note that the audit program recently introduced by the CRA does not appear to focus primarily on ways in which charities and non-profits carry on political activity by functioning together as part of the same family of organizations. Instead, the program seems to focus on whether charities are carrying on exclusively charitable activities and complying with the Act's rules on political activity. In some cases, the CRA identified compliance issues related to political activity while it was undertaking audits in respect of entirely different issues. Moreover, in instances where charitable status was revoked, multiple areas of serious non-compliance tended to be involved, not just compliance issues related to political activity.[5] That said, we would suggest that the other issues alone, without those related to political activity, would not have resulted in revocation.

Notwithstanding the apparently limited scope of the CRA's audit program, families of organizations continue to be cautious about drawing attention to themselves in the aftermath of the audits related to political activity. This is due, at least in part, to the fact that charities' reputations are critical to their success; even a suggestion of inappropriate behaviour can be extremely harmful to a charity's ability to fundraise.[6] Unfortunately for some charities, certain aspects of the political activity audits were heavily covered in the national news.

We begin this article by providing the necessary background for talking about charities and non-profits in a "planning" context. Then we discuss ways in which charities and non-profits are currently being used in the same family of organizations to carry on political activity. We conclude with a summary of the potential compliance issues that can arise when charities and non-profits are used in this way.

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2 Canada, Department of Finance, 2012 Budget, Budget Plan, March 29, 2012, at 436-37.

3 Canada Revenue Agency, "Minister Lebouthillier Announces Winding Down of the Political Activities Audit Program for Charities," *News Release*, January 20, 2016.

4 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

5 Remarks by Cathy Hawara, former Director General of CRA Charities Directorate, at the CBA's 2016 National Charity Law Symposium, May 27, 2016.

6 Reputation is critical for all charities and non-profits, including those that rely on members' fees as a source of annual revenue.

Although the rules in the Act need to be considered when one is designing and implementing structures that take into account the political-activity rules, the CRA needs to be flexible in its interpretation of the rules so that it does not inhibit positive change and growth in the sector.

A FAMILY OF ORGANIZATIONS: THE HISTORY

Large organizations in Canada, such as hospitals and universities, have used multiple entities for many years. Typically, an organization using this arrangement consists of (1) an operating charity and (2) a separate foundation that supports the operating charity by fundraising for capital purposes and making grants to the operating charity that are either for capital projects or simply to provide the charity's income for that year. Today, organizations' desire to have a greater impact[7] is driving innovation in how families of organizations are using multiple entities for different purposes.

The phrase "family of organizations" means two or more non-share capital corporations that are related to each other by virtue of the applicable corporate law.[8] It is used as an umbrella term to refer to the corporate group. On a basic level, non-share capital corporations in the same "family" are connected through their membership or through the structure of their boards of directors (as set out in their governing documents). In other words, the relationships are not typically driven by the related-persons and arm's-length rules in the Act[9] (or any other rules in the Act, for that matter), although these rules do come into play in various circumstances.

In addition to the familial relationships that arise from corporate law, relationships are established through licence agreements, service agreements, and other legal arrangements. Typically, charities and non-profits in the same family want to remain connected in order to prevent one entity from running off with the other's property or programs. They may also want to solidify their commitment to a shared mission.[10] It is particularly important to have written agreements in place if the

7 A recent example of the sector's exploration of new impact models is the development of social impact bonds (SIBs) as a means of financing charitable activities. In October 2016, the federal government announced that the Public Health Agency of Canada is working with the Heart and Stroke Foundation of Canada/Fondation des maladies du coeur et de l'AVC du Canada (Heart and Stroke) and Shoppers Drug Mart on a project designed to help Canadians lower their blood pressure. The Heart and Stroke SIB was supported by private investors (including resident and non-resident individuals and corporations) who provided the upfront capital to fund the project. The government will reimburse the investors if the project meets specific targets. Non-profits that are organized for social welfare or civic improvement purposes (as opposed to pleasure or recreation) are also actively exploring the use of SIBs; see Public Health Agency of Canada, "Minister of Health Announces Social Impact Bond for Heart and Stroke Health," *News Release*, October 28, 2016.

8 Such as the Ontario Corporations Act, RSO 1990, c. C.38, as amended; and the Canada Not-for-Profit Corporations Act, SC 2009, c. 23.

9 Section 251.

10 With respect to a shared mission, it is important to keep in mind that pursuant to paragraph 149(1)(l), non-profits are corporations that are specifically "not charities." Notwithstanding

licensor or service provider is a charity because charities cannot make outright grants to non-qualified donees (that is, non-profits).[11] Therefore, the agreements need to contemplate that the charity will receive not less than fair market value (FMV) consideration for anything transferred to a non-profit. The transfer of funds from a charity to a non-profit can occur in limited circumstances if the charity is carrying on its own activities through the non-profit and the appropriate written agreements are in place.[12]

Over the past 20 years, relatively few articles have been written on the use of multiple entities, including charities and non-profits, in the same family.[13] Most of them were published in the 1990s. They describe the most common structures in use and the reasons for using them, and the majority of these articles are still very relevant today. What they tell us, generally speaking, is that charities and non-profits are used together because non-profits have fewer constraints on their activities than registered charities do; that is to say, non-profits can carry on non-charitable activities. As we discuss below, non-profits are used to carry on political activity in excess of what is permitted to registered charities. Since charities can issue official donation tax receipts for income tax purposes, it is common for non-profits to spin off into a separate charity programs that properly qualify as charitable. Charities also generally have more flexibility than non-profits to earn income, including income from loans or other investments. In general, charities have the ability to accumulate, invest, and re-invest funds so as to further their charitable purposes directly and to generate revenue to fund these activities.[14] Another practical reason

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this fundamental difference between charities and non-profits, it is still possible for these entities to have the same or similar priorities.

11 Pursuant to the rules in subsection 149.1(1), charities are permitted to disburse funds to other qualified donees, such as other registered charities, or to carry on their "own activities" directly through their own staff, volunteers, or intermediaries.

12 See Canada Revenue Agency, *Charities Guidance* CG-002, "Canadian Registered Charities Carrying Out Activities Outside Canada," July 8, 2010; and *Charities Guidance* CG-004, "Using an Intermediary To Carry Out a Charity's Activities Within Canada," June 20, 2011.

13 See Douglas McPhie, "Control of Official Receipts in a Multi-Branch Environment" (1989) 8:3 *Philanthropist* 28-40; J.J. Coombs, "Advantages and Disadvantages of Charitable Organizations Establishing Separate Foundations" (1982) 3:2 *Philanthropist* 1-12; Arthur B.C. Drache, "New and Traditional Fundraising Methods," in *Report of Proceedings of the Forty-First Tax Conference*, 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990), 37:1-20; E. Blake Bromley, "Parallel Foundations and Crown Foundations" (1993) 11 *Philanthropist* 37-52; Jane Burke-Robertson, "Establishing a Parallel Foundation: Why? Why Not? How?" (1996) 13 *Philanthropist* 3-20; Jane Burke-Robertson, "The Use of Foundations, Business Vehicles and Not-for-Profit Corporations by Charitable Organizations," in *Charity and Not-for-Profit Law: The Emerging Specialty* (Toronto: Ontario Bar Association, 1997); and Linda J. Godel, "The How, Why, and When of Using Multiple Corporate Structures" (2007) 21:1 *Philanthropist* 18-35.

14 For example, a trade association might move its excess surplus into a foundation that could then endow those excess funds and use the income from them to concentrate on research and education (including scholarships for student members of the association).

to include a charity in a corporate group is to make it easier to receive grants from other charities and certain types of government funding.

POLITICAL-ACTIVITY REVIEW

Prime Minister Trudeau has expressed a desire to clarify the political-activity rules.[15] During the fall of 2016, a consultation process took place between the CRA and important stakeholders, including a number of charities that had undergone political-activities audits.[16] A panel of experts was constituted to produce a report and make recommendations on the rules to Minister of National Revenue Diane Lebouthillier sometime in 2017.[17] The report of the consultation panel was released on March 31, 2017 and has been very well received by the sector. The CRA is expected to respond to the report within the next few months (although the CRA has not provided a specific timeline).

Since the process undertaken to clarify the rules involves consultation with the CRA, it seems reasonable to expect that the changes will focus on the CRA's administrative policy. If the purpose was to make substantive changes to the language of the Act, the Department of Finance would most likely have played a visible role in the process. This approach may be disappointing to charities that perceive political activity to be inherently charitable and that are aware of the judicial relaxation of the political-activity rules in other common-law jurisdictions, such as New Zealand.[18] That said, significant aspects of the CRA's administrative policy need to be clarified.

It is worth noting that in August 2016, a constitutional challenge was launched by Canada Without Poverty (CWP), a registered charity that underwent a financial audit by the CRA that eventually turned into a political-activity audit. CWP has submitted that the limits on the political activities of charities in subsection 149.1(6.2) of the Act violate section 2(b) (freedom of expression) and 2(d) (freedom of association) of the Canadian Charter of Rights and Freedoms.[19] In the view of CWP, these Charter violations are not reasonably justified in a free and democratic society. Under section 1 of the Charter, the federal government can limit Charter rights if the government can establish that those limits are justified pursuant to a test developed

15 Office of the Prime Minister, "Minister of Finance Mandate Letter" (http://pm.gc.ca/eng/minister-finance-mandate-letter); see also Canada, Department of Finance, 2016 Budget, Budget Plan, March 22, 2016, at 206.

16 Canada Revenue Agency, "Minister Lebouthillier Announces Consultations with Charities To Clarify the Rules for Their Participation in Political Activities," *News Release*, September 26, 2016.

17 See Canada Revenue Agency, "Clarifying the Rules Governing Charities' Political Activities: Consultation Process 2016 to 2017," March 16, 2017 (http://www.cra-arc.gc.ca/chrts-gvng/chrts/cmmnctn/pltcl-ctvts/cnslttn-prcss16-17-eng.html).

18 *In re Greenpeace*, 2014 NZSC 105.

19 Canadian Charter of Rights and Freedoms, part I of the Constitution Act, 1982, being schedule B to the Canada Act 1982 (UK), 1982, c. 11.

by the Supreme Court of Canada in *R v. Oakes*.[20] The CWP case will be carefully watched over the coming months.[21]

THE IMPLEMENTATION OF DUAL STRUCTURES

The CRA has not published guidance that deals directly with the use of structures that combine charitable entities with non-profits; thus, the principal sources of information about the CRA's views in this area are its response to applications for the registration of charities that are part of such structures and its other dealings with charities and non-profits.

The main compliance issue that needs to be considered when charities and non-profits are being used in the same family is that the Act prohibits gifts of funds or other property from a charity to a non-profit. As explained above, such transfers are not impossible, but they must be done pursuant to carefully structured written agreements, with value accruing to the charity. Transfers from non-profits to charities can be done more easily or for nil value, if desired. In addition, a charity must always receive FMV for services that it provides.

The CRA can also require that entities maintain clearly separate identities. At a minimum, separate entities must maintain separate books and records (surprisingly, such separation does not always occur). Further, each entity may be required to maintain separate websites and programming-related materials. When non-profits are used to carry on political activities in excess of the 10-percent rule, it is especially important to the CRA that the public be able to clearly identify which activities belong to the charity and which to the non-profit. If (as has happened in the past) the CRA does not specifically require this as a condition of registering a charity that is part of a dual structure, the separate identities of the charity and the non-profit may not be immediately apparent.

The composition of the governing boards is also important in establishing separate identities for a charity and a non-profit that are part of a dual structure. The complete overlapping of the two boards might contribute to a CRA conclusion that there is insufficient separation between the two entities. It is not necessary, on the other hand, to go to the other extreme and have completely distinct boards; some crossover between the boards of directors of both entities may be possible, since there are no rules against it in the Act or in CRA administrative policy. Also, the composition of a charity's board is one of the factors that the CRA will consider when deciding whether to designate a particular entity as a private foundation or a public charity. This designation can be important to some charities, depending on whether they intend to carry on any related business activities, hold in excess of 20 percent of the shares of the capital stock of a corporation, or accept certain types

20 [1986] 1 SCR 103.

21 "Canada Without Poverty Launches Charter Challenge to Restrictions on Freedom of Charities To Promote Changes to Laws and Policies," August 8, 2016 (http://www.cwp-csp.ca/2016/09/canada-without-poverty-launches-charter-challenge/).

of gifts of shares. In some instances, where a majority of the directors or trustees of a charity also sit on the governing board of the non-profit, the CRA may designate that particular charity as a private foundation.

Case law on this question is limited principally to the 1999 decision of the Federal Court of Appeal in *Alliance for Life v. Minister of National Revenue*, which dealt with a situation involving a charity and a non-profit in the same family.[22] The case involved an appeal by a charity (Alliance for Life) of the minister of national revenue's decision to revoke the charity's registration under the Act. Alliance for Life was a broad-based pro-life organization with numerous affiliate member groups across Canada. During an earlier audit of Alliance for Life's activities, the CRA had suggested to the organization that certain of its activities, found by the minister to be "non-charitable activities," should be transferred to a separate non-profit. As recounted in the court's judgment, the minister seemed to be content with this approach and provided some guidelines to the charity on how the transfer should occur. Alliance for Life was audited again after implementing the new structure and was criticized for its failure to maintain sufficient separation between the charity and the non-profit.

In the subsequent audit, the minister took the position that certain non-charitable activities, including political activities, had been maintained in Alliance for Life. The minister also took the view that loan funds transferred from the charity to the non-profit, funds that were meant to be transferred as an investment in the non-profit, were inappropriate because the funds were not transferred on market-rate terms. The minister said that "the effect of this division has been to separate funds received based on whether an official donation receipt is requested, rather than to remove the activities which are not charitable from those of the registered charity."[23]

The case ultimately turned on whether Alliance met all of the requirements to be a charitable organization under the Act and at common law. In reviewing the facts in light of the applicable law, the Federal Court of Appeal found no reason to interfere with the minister's decision. The court did not address whether the charity and the non-profit had been operating in a manner that was sufficiently separate.[24]

This case has been followed and cited in a few other decisions;[25] however, as with much of the Canadian taxation of charities and non-profits, there is no significant body of case law on this subject.

CONCLUSION

The use of charities and non-profits in the same family of organizations can be an effective way to carry on a variety of different activities, including political activity.

22 *Alliance for Life v. MNR*, [1999] 3 FCR 504 (CA).

23 Ibid., at paragraph 15.

24 Ibid., at paragraphs 40-65.

25 See *Action by Christians for the Abolition of Torture v. Canada*, 2002 FCA 499.

Charities and non-profits today are particularly motivated by the desire to have a greater impact through the use of dual structures and of even larger, more diverse ones. Although we have not discussed them in this article, other structuring options being explored involve the use of for-profit subsidiaries, hybrid social enterprise structures (the Community Contribution Company in British Columbia and the Community Interest Company in Nova Scotia), limited partnerships, and trusts.[26]

We hope that the CRA, in clarifying its interpretation of the political-activity rules, will provide for more flexibility. In any event, the ability of charities and non-profits to work together will allow them to continue to meet their program goals despite restrictive rules.

26 See, for example, Sukhdeep Singh Sembi, "Community Interest Company and Community Contribution Companies," *Drache Aptowitzer LLP Charity Law Insights*, December 22, 2016 (http://drache.ca/articles/community-interest-corporations-and-community-contribution-companies/); Arthur B.C. Drache, "Non-Profits and Taxable Subsidiaries," *Drache Aptowitzer LLP Charity Law Insights*, April 30, 2014 (http://drache.ca/articles/charities-article-archive/non-profits-and-taxable-subsidiaries/); Terrance S. Carter and Theresa L.M. Man, "Canadian Registered Charities: Business Activities and Social Enterprise—Thinking Outside the Box," in *Structures at the Seam: The Architecture of Charities' Commercial Activities*, National Centre on Philanthropy and the Law Annual Conference, October 24, 2008 (http://www.carters.ca/pub/article/charity/2008/tsc1024.pdf).