

# Legal Limberness



## Credits and authors

For Accounting Athletics

David Nanton, CA (2010 version)  
Financial Management Consultant, NFP sector  
davidnanton@shaw.ca

Bill Cox, CA (2007 version)  
Partner, BDO Dunwoody  
bcox@bdo.ca

For Cashflow Calisthenics and Financial Fitness

Catherine Ludgate  
Manager, Community Investment, Vancity  
catherine\_ludgate@vancity.com

For Enterprising Exercises

Elizabeth Lougheed-Green (2013 version)  
Manager, Community Investment, Vancity  
elizabeth\_lougheedgreen@vancity.com

Cam Brewer (2007 version)  
Restraint Consulting  
cam@web.ca

For Legal Limberness

Mary Childs, BA, LLB, BCL (2013 version)  
Ethos Law Group LLP  
mary@ethoslaw.ca

Richard Bridge, BA, LLB (2007 version)  
Barrister & Solicitor  
richardbridge@ns.sympatico.ca

Editing and content wrangling handled by:

Donna Barker  
Principal, Donna Barker Communications  
donna@donnabarker.com

Layout and design provided by:

Justin Ho (2010)  
justin\_ho@shaw.ca

Funding for the Financial Fitness series was originally provided in 2007 by the Community Development and Partnerships Directorate of Human Resources and Social Development (HRSD) Canada. Cashflow Calisthenics was subsequently developed by Vancity and in 2009, with the support of a Shared Success grant from Vancity, the entire suite of workbooks was updated. In 2010, Enterprising Exercises was added to the series. And, in 2013, Accounting Athletics and Legal Limberness were updated to reflect changes in the rules and laws that govern not-for-profit organizations and charities.

The views in these handbooks are entirely the authors' own, and may not reflect the views of HRSDC, Vancity or any other partner organizations.

Vancouver City Savings Credit Union © 2013



# Table of Contents

<b>Legal Limberness cover page</b>	<b>1</b>
<b>Financial Fitness</b>	<b>7</b>
<b>1. Introduction</b>	<b>9</b>
<b>2. Being prepared for legal issues</b>	<b>13</b>
<b>3. Governing documents</b>	<b>15</b>
Federal corporations with letters patent – transition from CCA to NFP Act	16
Constitution and amendments	16
Bylaws and resolutions	17
Mission statement	18
Records of Board decisions and/or membership meetings	19
Membership records and other records required by law	19
Policy statements	20
Government filings	20
Charitable registration	21
Access to Records	21
Contractual records	22
Unanimous member agreements	22
<b>4. Relationship between members, Directors and Officers</b>	<b>23</b>
Role of the Board of Directors	23
Role of Executive Director	24
Executive Director’s responsibilities to the Board	24
Board’s responsibilities to the Executive Director	24
Role of senior program staff	25
Senior program staff’s responsibilities to the Board	25
Board’s responsibilities to the senior program staff	25
Role of accounting and bookkeeping staff	25

Accounting and bookkeeping staff's responsibilities to the Board	25
Board's responsibilities to the accounting and bookkeeping staff	26
Role of the external auditor	26
Auditor's responsibilities to the Board	26
Board's responsibilities to the organization	26
<b>5. Governance issues</b>	<b>27</b>
Duties of Directors	27
Board management	29
Who is in control?	29
Choosing new Board members	30
Reducing Board liability	31
<b>6. Meetings of members</b>	<b>33</b>
Annual meetings	33
Special meetings	34
<b>7. Fundraising</b>	<b>35</b>
Operating outside British Columbia	35
Provincial and federal fundraising legislation	36
Personal Information Protection Act	36
Society Act	36
Gaming	36
Other Licensing Requirements	36
The Income Tax Act	36
Donor's rights	37
Sponsorships	37
Joint venture agreements	37
<b>8. Special legal responsibilities of charities</b>	<b>39</b>
Engaging in allowable activities	40
Keeping adequate books and records	41
Issuing complete and accurate donation receipts	42
Split-receipting	43
Anti-tax shelter provisions	43
Meeting annual spending requirements (disbursement quota)	44
Filing an annual T3010 information return	44
Changing the charity's mode of operation or legal structure	46
Goods and services tax checklist for charities	46
Operating outside Canada	48
Political activities	49
Related business activities	50

## 9. The legal context for social enterprises

51

Options for structuring social enterprises	51
Registered charities and business ventures	53
How does CRA decide that a charity is carrying on a business?	53
Can you operate your business within your charitable organization?	54
What if your business is unrelated?	55
Business as a charitable program – community economic developmen	55
Summary of social enterprise categories	56
Legal structures for social enterprises	56
As a program or activity within the main organization	56
As a separate for-profit subsidiary	57
As a separate not-for-profit	57
As a co-operative	57
Joint ventures or partnerships	57



# Financial Fitness by Vancity

The *Financial Fitness* series was developed by Vancity credit union to assist small and medium-sized not-for-profits and co-operatives to acquaint themselves, or reacquaint themselves, with the basics of operating a financially healthy and resilient organization. Not-for-profits always operate in the arena of change and uncertainty. The Sector Monitor published by Imagine Canada reported in October 2012 that charity leaders generally predicted increased challenges in the year ahead. Research done by the Ontario Trillium Foundation indicates the best way to support not-for-profits is to assist in developing resiliency, so not-for-profits can bounce from moment to moment and opportunity to opportunity.

The goal of the *Financial Fitness* series is to help with that resiliency, and in particular, to demystify some of the key financial, legal and accounting concepts which sometimes keep not-for-profits from feeling in control of their destinies, or speaking truth to power when dealing with allied professionals and funders.

*Legal Limberness* addresses the fundamental legal issues, from the duty of care to statutory obligations, for which the Board of Directors and senior staff (Executive Director and program managers) are responsible.

*Accounting Athletics* addresses the role and responsibilities of the Board and more specifically, the Finance Committee – the Treasurer, Executive Director, Accountant or Bookkeeper – in reading financial statements, what to look for and when to be concerned.

*Cashflow Calisthenics* focuses primarily on the roles and responsibilities of senior staff to maintain the financial well-being of a not-for-profit organization. It includes advice on cash flow planning and developing “what-if” scenarios, and provides guidance on how to work with allied professionals to improve cash position.

*Enterprising Exercises* supports the staff and board of organizations that are currently operating a social enterprise. It poses important operational questions, and provides tools and success metrics to help identify areas where a social enterprise could be made stronger or more focused.

Each of these four handbooks fits within the overall framework of *Financial Fitness*, an introductory course for improving the financial health and resiliency of not-for-profit organizations.

Canada’s not-for-profit and voluntary sector is the second largest in the world, according to Imagine Canada. The full charitable and not-for-profit sector (including hospitals and universities) is the 11<sup>th</sup> largest contributor to Canada’s gross domestic product (GDP) and plays a vital role in our country’s economy, in addition to providing critical services to people and strengthening communities.

In 2007, Statistics Canada changed the way it tracks not-for-profit organizations in Canada, breaking the sector into three industry sectors:

- non-profit institutions serving households (NPISH), about 22% of all not-for-profits by GDP (religious, welfare, arts, entertainment, recreation, educational services and 'other');
- corporate sector, about 13%; and
- government sector, 65% of all not-for-profits (hospitals, universities and colleges).

In 2009, the NPISH sector alone accounted for \$22.1 billion of GDP activity and employed almost 529,000 people. Overall, the not-for-profit sector in Canada employs two million people and accounts for \$106 billion of the GDP.<sup>1</sup>

That information alone is exceptional, but when layered with the fact that fully 54% of Canadian not-for-profits and charities are run entirely by volunteers – the collective accomplishments of these 161,000 organizations are truly awe-inspiring.

In British Columbia there are over 20,000 not-for-profit organizations, about half of which are also registered charities. Across BC, 1.5 million people volunteer, including on boards.

Common to all organizations are challenges of having stable funding (two-thirds of organizations experience this), planning for the future (55% of organizations experience this) and having enough volunteers, particularly at the board level (50% report this as an issue).

We hope these handbooks help build that core of financial health and resiliency of individual not-for-profits, and contribute to the collective financial fitness of the not-for-profit sector.

The *Financial Fitness* series is not meant to replace qualified financial, accounting or legal advice from professionals, but we hope these handbooks and the affiliated workshops will contribute to the collective financial fitness of the not-for-profit sector.

---

<sup>1</sup> For more information and not-for-profit statistics see, [www.hrcouncil.ca/documents/LMI\\_moving\\_forward.pdf](http://www.hrcouncil.ca/documents/LMI_moving_forward.pdf) and [www.imaginecanada.ca/node/32](http://www.imaginecanada.ca/node/32)





# 1. Introduction

Legal Limberness was written primarily as a resource for Directors and senior staff, to provide an overview of many of the key governance issues and legal responsibilities of Board members and senior management.

While the information presented here is largely an overview of many legal and regulatory concepts, it provides a sound starting point for your organization's Board and management team to identify knowledge gaps so you can seek appropriate expert advice in a timely manner.

As the expression goes, “a little knowledge is a dangerous thing” – we hope this handbook will provide the impetus for further due diligence in the areas most applicable to your own situation.

Background: Some Key Concepts

We'll begin with a brief overview of some of the basic legal principles that set the stage for more specific discussions.

Legal Personality

In law, an incorporated body (including a BC Society, a federal not-for profit corporation, or a co-operative) has a legal existence separate from that of its members, directors and staff. It has the legal powers to do many things real persons can do: own property, enter into contracts, sue and be sued. Like a real (in legal terminology, “natural”) person, it has a “birth” (incorporation) and a “death” (dissolution). And, like natural persons, it is subject to many laws regulating its activities.

Incorporation – Federal or Provincial?

In Canada, we have two levels of government with the power to regulate not-for-profits and co-operatives. Both have passed laws that permit such entities to be established, and those laws regulate certain aspects of how the entities operate. Thus, the British Columbia Society Act permits incorporation of not-for-profits, as does the federal Canada Not-for-profit Corporations Act (the “NFP Act”). The British Columbia Cooperative Association Act governs most co-operatives in BC, and the Canada Cooperatives Act regulates co-operatives operating in more than one

## Legal Limberness

*“A little knowledge is a dangerous thing...”*

- **Resource for Directors and senior staff**
- **Overview of regulatory and legal concepts**
- **Support due diligence**

## Key concepts

- **Legal personality**
- **Incorporation - federal or provincial**
- **Limited purposes**
- **Charitable status**

province. Although some general principles apply to all not-for-profits and co-operatives, there are significant differences between the various Acts and you should review the one applicable to your organization. Each has its own set of rules, and you should know which applies to you.

If your not-for-profit was incorporated federally before the Canada Not-for-profit Corporations Act came into force, you may still be subject to the rules contained in the Canada Corporations Act (the “CCA”) which preceded the current statute. Every federal not-for-profit created under the CCA is required to file a transition application before October 17, 2014, after which it will be regulated by the NFP Act. Any CCA corporation which does not file a transition application before that date will be assumed by Industry Canada to be inactive and will be dissolved –it will cease to exist.

#### Incorporation – The basics

A not-for profit or co-operative is “born” when an incorporation application is accepted by the relevant government. For a BC society, for example, five individuals must sign an application agreeing to abide by a particular constitution and set of bylaws. If their application is accepted, those individuals become the first members of the new Society and the persons named in the application as the Directors, form the Board. From then on, membership and composition of the Board is regulated by both the Society Act and the bylaws of the new entity. The new society is issued with a Certificate of Incorporation showing the date it came into existence, and its number in the corporate registry.

The process for incorporating a federal not-for-profit is similar. The application includes Articles, which set out the entity’s purposes, number of directors, province of head office, restrictions on activities, distribution of assets, and other optional provisions. Additionally, the application must name the first directors and give the address of the head office. The organization will also have to adopt by-laws, and all bylaws must also be filed with the Director. The website of Corporations Canada has very helpful guides to the incorporation process, including a “bylaw builder” to help you create a customised set of bylaws for your organization.

An application to incorporate a BC co-op must be signed by three or more individuals who, by signing, agree to subscribe to its Memorandum of Association. These applicants will become the first members of the co-op. At least three initial directors must be named in the application, all of whom must be among the first members (the subscribers to the Memorandum). When the co-op is incorporated, its Memorandum is the equivalent of a Society’s constitution, and the co-op has Rules rather than bylaws.

#### Limited Purposes

Unlike a natural person or a for-profit corporation, a not-for-profit can only use its legal powers for certain purposes. Those purposes are set out in its constitution or Articles (or, for a CCA corporation which has not yet

transitioned to the NFP Act, its letters patent). Similarly, a co-operative's purpose will be set out in its Memorandum, as will be any restrictions on its powers or the business it may carry on. If the entity does things which are not consistent with those purposes, it is said to be acting *ultra vires* (beyond its powers) and the legal consequences may be significant. It is critical that all Board members and senior staff are familiar with your organization's legal purposes.

#### Charitable Status

Incorporation and charitable status are two separate things. Only about half of all not-for-profits ever seek charitable status. Many organizations prefer to keep only society registration.

Charitable status is regulated by the Canada Revenue Agency ("CRA"). If the application for charitable status is successful, the entity becomes a registered charity (listed in a registry in Ottawa), and can issue charitable tax receipts to its donors.

In order to be granted charitable status, an entity must be created for exclusively charitable purposes; thus the statement of purposes set out in its letters patent or constitution is extremely important.

Co-operatives as well as not-for-profit corporations can apply for charitable status. In BC, not-for-profit co-ops can incorporate as "Community Service Co-ops", which have the same status in law as not-for-profit societies.





## 2. Being prepared for legal issues

All not-for-profit organizations in Canada operate in a complex and often confusing legal and regulatory environment. The emphasis in this section is on legal rules applicable to Directors and senior staff, as the individuals who are responsible for making sure the organization runs smoothly and avoids legal problems. Whether you've been told about those rules or not, each Director or senior staff person has a legal and moral obligation to both understand them and ensure the organization is being managed accordingly.

Understanding how the legal rules work helps you maximize the advantages available to your not-for-profit organization and avoid potential pitfalls. One of the best ways to protect your organization from having to deal with a legal problem is to be fully aware of all the governance and legal documents that your not-for-profit has developed. The first step is simply to develop a list of key documents and to place copies of each in a central location where they are easy to access.

The following list is comprehensive; your not-for-profit may not have all of these documents. Some apply only to federally-incorporated entities, for example, while others are specific to charities. It's a good exercise to review the entire list and, if your organization does not have certain documents, determine whether this should be addressed.

### Important documents

- Letters patent (and supplementary letters patent, if applicable)
- Articles of Incorporation
- Constitution and amendments
- Bylaws and resolutions
- Unanimous member agreement
- Mission statement
- Records of Board decisions and membership meetings
- Membership records
- Policy statements

### Being prepared for legal issues

- **Complex and confusing legal and regulatory environment**
- **Role of volunteer Board member tied to many rules**
- **Maximize advantages while avoiding pitfalls**
- **Awareness and proper documentation are essential**

- Government filings
- Charitable registration
- Memorandum and Rules
- Contractual records

Other legal documents

- Documents relating to charitable assets
- Leases, deeds and mortgages
- Agency, association and joint venture agreements
- License agreements
- Business name, trade-marks, domain names



## 3. Governing documents

As noted earlier, a not-for-profit may incorporate either federally or provincially. If the organization is to carry on its activities in more than one province under the same corporate name and wishes to move its registered office around the country with ease, it may wish to incorporate federally. A local organization that works at a community level or in just one province usually incorporates provincially. An organization that is incorporated federally will also be required to register as an “extra-provincial” organization, in at least one province, depending on the nature of its activities in each province. For example, a federally incorporated not-for-profit carrying on business in British Columbia will be required to register with the Corporate Registry in Victoria.

A co-op will almost always be incorporated provincially, as federal law says incorporation is restricted to co-ops operating in two or more provinces. Any cooperative operating in British Columbia which was not formed under the Cooperative Associations Act is required to register here as an extra-provincial cooperative association.

### **Governing documents**

- **Federal or provincial rules**
- **Purpose must be stated**
- **Legal powers limited by purpose**

---

### **Recommended actions:**

1. Review your organization’s incorporation documents and make note of whether it has been provincially or federally incorporated.
  2. Review all activities undertaken by your organization, including fundraising appeals, to ensure these activities are aligned with the purposes set out in your incorporation documents.
  3. If you find that you’re provincially incorporated and engaging in activities outside your province, seek legal advice.
  4. If your organization is federally incorporated, check that it has any required provincial registrations.
-

## Federal corporations with letters patent – transition from CCA to NFP Act

If your organization is federally incorporated under the CCA (the predecessor to the NFP Act), the letters patent is the legal document issued by the federal government that granted your organization status as a corporation. If your organization changed its purposes as stated in the original letters patent, it may have applied for and obtained supplementary letters patent.

The old letters patent model under the CCA has now been replaced by a different structure under the NFP Act, which follows an approach closer to that under the for-profit business corporations statutes. All federal not-for-profits which were incorporated under the CCA are required to file a transition application before October 17, 2014, when they do this, their letters patent will be replaced by Articles.

---

### Recommended actions:

1. Review your Articles to ensure that the operating name of the organization is the registered name and that its objects are exclusively charitable.
  2. Review all the activities carried out by the charity to ensure they are authorized by its charitable objects.
  3. Review the dissolution clause to ensure it is complementary to the charitable objects.
  4. Prepare and file a transition application, if your entity was incorporated under the CCA.
- 

### Important documents

- **Letters patent**
- **Constitution and amendments**
- **Bylaws and resolutions**
- **Mission statement**
- **Records of Directors, members and debt**
- **Membership records**
- **Policy statements**
- **Government filings**
- **Charitable registration**
- **Contractual records**

## Constitution and amendments

If your not-for-profit is incorporated provincially in British Columbia, its name and purposes will be set out in a constitution. You should review the constitution at least every two years, to ensure you are acting in accordance with your stated purposes. The most important concern is that you not undertake work beyond the stated purposes. You are not required to pursue all your purposes all the time. It is perfectly legal to have listed in your purposes a number of things you would like to do but cannot yet pursue due to limited resources or other circumstances.

Amending a constitution must be done following the guidelines established in your bylaws and in the *Society Act*. In most cases this will entail three-quarters of the members who are present at the annual general meeting voting in favour of the amendment. If the society has a small membership, the special resolution can be passed in writing if all members sign to show their agreement. Some organizations have provisions in their constitutions



which are unalterable, and these provisions cannot be changed by the members. For a BC Society, amendments are not legally effective until they are filed with the Corporate Registry in Victoria. Simply passing the changes at a meeting of the members is not enough. This becomes very important if you want to pass a borrowing resolution; your financial institution may decline to lend to you, even if your members have passed a resolution in favour of borrowing, but that resolution has not yet been registered in Victoria (because the financial institution cannot rely on that resolution without its registration).

---

**Recommended actions:**

1. Review your constitution and amendments to ensure the purposes are clearly stated and correctly reflect how the organization actually operates.
  2. Find documentation that confirms that the current constitution is filed with the appropriate government agencies, such as the Canada Revenue Agency and the Corporate Registry.
- 

## Bylaws and resolutions

Your organization's bylaws are your ruling documents. They are critical because they tell you how to conduct the business of your not-for-profit. Because bylaws and rules are legal documents, it's important to consult with a lawyer before adopting any new bylaws or changing existing ones.

Examples of common bylaws include guidelines related to the following structure and abilities of the Board:

- regularity of general meetings and executive meetings
- the number of Directors the organization should have
- terms of office for Directors (how many years a term is and how many terms a Director can sit)
- how Board vacancies will be filled
- criteria for dismissing a Board member
- how many Officers the organization will have and their titles (Chair, Vice-chair, Secretary and Treasurer are most common)
- responsibilities of each Officer
- what committees the organization will have, their structure and authority
- how often meetings will be held and how many days before each meeting the agenda will be circulated
- rules around voting and what constitutes quorum
- rules around conflict of interest
- fiscal policies

---

**Recommended actions:**

1. Review your organization's bylaws at least every three years.
  2. Ensure your bylaws do not conflict with your letters patent, Articles or constitution.
  3. Review bylaws in relation to any changes in legislation to ensure they are on-side.
  4. Ensure there is adequate indemnification provision.
- 

## Mission statement

The purpose of your mission statement is to convey to your staff, Board, and members of the community your organization's reason for being. Your mission statement is more than just a series of catch-phrases and ideals; when used properly, your mission statement informs your organization's goals and programming and guides decision-making for all levels of management, including Board members.

Not-for-profit organizations that have been in existence for several years sometimes find themselves having suffered something called "mission drift" and may be delivering services and programs that are outside of the scope of their mission statement.

---

**Recommended actions:**

1. Review the mission statement at least once every two years.
2. Ensure that the mission statement that is being used to inform day-to-operations is consistent with the purposes set out in your governing documents.
3. When reviewing your mission statement, ask questions such as:
  - a. does the mission statement accurately reflect the purpose and the aim of the organization *today*?
  - b. Does it accurately reflect the primary stakeholders or clients we are working with and our responsibilities to these stakeholders?
  - c. Are the services we offer reflected in the mission statement?

If you answer 'no' to any of these questions, either your mission statement should be updated, or your programming should be changed so that the two are aligned.

---

## Records of Board decisions and/or membership meetings

Generally, it is the Secretary's responsibility to take minutes at all Board meetings and at all meetings of members, including special meetings and the Annual General Meeting. In addition to recording all decisions made at these meetings, recording attendance also falls to the Secretary. By law, records of meetings must be kept in the corporate records of your not-for-profit.

---

### **Recommended actions:**

1. Ensure the Secretary understands what information must be captured in the minutes at all Board and membership meetings.
  2. Find and create hard copies of all Board and membership meeting minutes and keep these together in one file; also, ensure one set of hardcopy minutes are signed by two authorized signers, to prove their veracity.
  3. Create a separate document for all decisions that impact the operations of the organization.
- 

## Membership records and other records required by law

The Society Act requires all BC Societies to keep a register of members, including a record of each member's name and address. Federal law also requires federally incorporated not-for-profits to keep such records, as well as accounting records, registers of Directors and Officers and, if the corporation has issued debt obligations (such as bonds), a register of those debt obligations. Failing to keep these records is an offence; more importantly, it can create significant problems in determining whether meetings have been properly held, actions properly authorised, and Directors properly elected.

The Cooperative Association Act also requires co-ops to keep registers of members and Directors. If the co-op has issued investment shares, there must be a separate register of investment shareholders.

---

### **Recommended action:**

1. Check that all required registers are current and contain the required information.
-

## Policy statements

Policy statements are neither wish lists nor mission statements; they are an official expression of the principles that direct an organization's operations.

Policies every organization should consider adopting include:

- Volunteer conduct
- Sexual and racial harassment
- Bullying
- Safety in the workplace
- Insurance
- Privacy
- Investment
- Hiring and termination

Well-written policy statements are concise and should contain the following elements:

- Statement of purpose
- Scope
- Definitions of key terms
- Definition of guiding principles
- Roles and responsibilities
- Timelines for updating
- References to other relevant policies or laws
- Authority/ies under which the policy is being developed
- Guidelines for implementation

---

### **Recommended actions:**

1. Find and review all of your organization's policy statements to ensure they are being observed and that they meet current laws.
  2. For areas where policies have not been created, meet with the Board to discuss steps to put new policies in place.
- 

## Government filings

Your not-for-profit or co-operative must file an annual report with the appropriate body in its jurisdiction of incorporation (for federally incorporated bodies this is Industry Canada, for BC Societies and co-operatives it is the Corporate Registry in Victoria) and any province or territory where it is extra-provincially registered. A body that fails to file its annual reports for two years may be "struck from the register," which means

it will cease to exist legally. This happens to several hundred BC Societies each year. If the Society changes its offices or its Directors, notice of the changes should be filed with the appropriate bodies.

---

**Recommended actions:**

1. Ensure the activities of the most recent completed fiscal year have been reported.
  2. Move one complete set of filings off-site, in case of theft or fire loss of these documents from the office.
  3. If you are federally incorporated, determine how transition to the Canada Not-for-profit Corporations Act affects your organization and take appropriate action to maintain status.
  4. If your organization operates and/or engages in fundraising outside of British Columbia, ensure all proper extra-provincial registrations have been undertaken and reporting has been maintained.
  5. If your organization is a charity, ensure you have filed an annual Registered Charity Information Return.
- 

## Charitable registration

If your organization is a charity registered with the Canada Revenue Agency, it will be subject to further annual filing requirements. For details, see section 8 of this handbook, Special legal responsibilities of charities.

---

**Recommended actions:**

1. Review the initial corporate organization of the charity to ensure it was properly done.
  2. Review all external marketing, outreach and fundraising materials to ensure your charitable status number is included on these documents.
  3. Ensure that the charity has filed all required information with the CRA.
- 

## Access to records

A BC Society's corporate records, or "minute books," may be inspected by its Directors and members unless its bylaws provide otherwise. A federally

incorporated not-for-profit is required to give members, creditors and Directors access to certain corporate records; it cannot restrict access through its bylaws. The *Cooperative Association Act* contains very detailed rules about the records which must be kept at the co-op's office, and who must be given access to those records.

---

**Recommended actions:**

1. Check the governing statute to make sure you know which records members and Directors are entitled to inspect, when they may inspect them, and what fees, if any, may be charged for copies.
  2. If necessary, amend your bylaws to make sure that access to records is consistent with privacy laws.
- 

## Contractual records

Contractual records need regular attention. Documents such as leases, employment contracts, and insurance are too often misplaced or ignored. Having all of these in place will put an organization in a solid position in the event of a spot audit by CRA.


---

**Recommended actions:**

1. Ensure that responsibility for contracts is clearly assigned.
  2. Routinely review the relationships and obligations in all contracts, to ensure they are being followed.
  3. Ensure that staff are aware of, and follow, Board rules related to when they are and are not allowed to sign contracts; too commonly, the total dollar value (or potential exposure to the not-for-profit) is not considered when staff sign a contract for the lease of premises or equipment, or a contract for employment.
- 

## Unanimous member agreements

Under the *Canada Not-for-profit Corporations Act*, the members of a federal not-for-profit may all sign an agreement to restrict the powers of the directors, provided that the corporation is not a “soliciting corporation” (one which gets more than a specified amount of its funding from donations or government sources). If your organization has such an agreement, make sure your Board and members all understand its terms and implications.



## 4. Relationship between members, Directors and Officers

Not-for-profits can be organized in many ways, but one common structure has members electing Directors, who then hire and supervise Officers (senior/management staff). If you imagine the entity as something like a small country, the members are the voters and the Directors are like elected politicians, who adopts rules and set policy. The staff, including Officers, are like the civil servants whose task is to implement those policies and make day-to-day operational decisions.

Under the Canada Not-for-profit Corporations Act, the Directors must be elected by the members, but the Society Act is more flexible. It permits Directors to be appointed by other directors, or even by outside bodies, although such structures are unusual. Co-op Directors must be elected by the members – democracy is central to the principles of the co-op movement.

### Role of the Board of Directors

The Board is the governing body of the organization. Its responsibilities include both big-picture planning and careful monitoring of the organization's operations. Specifically, it is a Director's job to:

- Develop policies and to document policy decisions
- Create and update the mission and vision (when necessary)
- Approve operating plans and the annual budget
- Set annual goals for the organization
- Approve major contracts and grants

#### **Organizational relationships**

1. **Members elect Directors**
2. **Directors hire Officers (management and staff)**
3. **Officers implement policies**

#### **Board of Directors**

- **Governing body**
- **Big picture + small details**
- **Monitor operations**

- Review program evaluations
- Participate in fundraising efforts by both donating money and soliciting donations
- Hire, and evaluate the performance of, the Executive Director
- Not interfere with day-to-day operations
- Not rubber stamp decisions

## Role of the Executive Director

Of course, every organization will have a unique and detailed job description for its Executive Director. But all not-for-profits, no matter what their size or mandate, need a leader who has certain skills and knowledge. The Executive Director should have at least a basic ability in the following broad areas of responsibility. He or she should be:

### **Role of Executive Director**

- **Unique to each organization**
- **Leader, visionary, decision-maker, manager**
- **Provides information for Board to make operational decisions**
- **Board and Executive Director are responsible to each other**

- a leader to staff, the Board and external stakeholders;
- a visionary who looks to the future to seize opportunities and to mitigate threats;
- a decision-maker who both provides clear and ample information to the Board and to staff who implement programs;
- a manager who oversees the human, physical and financial resources of the organization; and
- a Board developer, who keeps the Board informed and supports the Board in identifying new members and evaluating current members.

### **Executive Director's responsibilities to the Board**

What can the Board expect of its Executive Director? Quite simply, enough information to make informed decisions about the overall operations of the organization.

### **Board's responsibilities to the Executive Director**

The Board's main responsibility to the Executive Director is to provide the staff leader with an annual evaluation of his or her work. Many use the language of John Carver to describe this as ends and means: the Board's responsibility is to articulate the results it wishes to see (the ends) and entrusts the Executive Director with how those results are achieved (the means).

An annual evaluation should be carried out by a committee of the Board, not just one person. There are many resources available to Boards to help guide such an evaluation -- doing an informal review is not good enough. The annual evaluation should address how well the Executive Director is managing your organization's finances, revenue, human resources, programs, work environment, planning, and relationship with your Board.



## Role of senior program staff

In most not-for-profits, senior program staff, as opposed to the Executive Director, do the majority of the work implementing the organization's programs. In some situations they have responsibility for staff and managing the budgets of the programs they oversee, including fundraising to support the program delivery.

### **Senior program staff's responsibilities to the Board**

Technically speaking, senior staff are not directly responsible to the Board of Directors, but to the Executive Director. That, however, is not to say that the Board can't have a direct line of communication with senior program staff. And in some situations you may find it in the best interest of your organization to include senior staff in Board meetings, for instance, if the Executive Director is unable to provide adequately detailed information about programming to make good governance decisions.

### **Board's responsibilities to the senior program staff**

The Board's responsibility is to the overall health of the not-for-profit it governs, which directly affects all staff who are employed by the organization. The Board's specific responsibility to senior program staff is to approve the objectives or outcomes that staff are expected to achieve.

## Role of accounting and bookkeeping staff

The role of the accountant or bookkeeper, as it relates to the Board, is to manage and report on the revenue and expenses of the organization. He or she will work closely with the Board Treasurer and will be a part of the organization's Finance Committee (which will also include the Executive Director). He or she will also support the external auditor on an annual basis.

### **Accounting and bookkeeping staff's responsibilities to the Board**

Working with the Executive Director, and possibly with senior program managers, the accountant or bookkeeper will prepare a realistic annual budget for the organization and share that, with rationale for the numbers, with the Board. He or she will prepare financial statements, at least quarterly, for presentation to the Board and in a perfect world, monthly cash flow statements. The financial statements will have comparative information for the previous year and staff should be able to explain large discrepancies in year-to-year statements to the Board.

### **Role of senior staff**

- **Implement programs**
- **May manage staff, budgets, fundraising**
- **Responsible to Executive Director**

### **Role of accounting and bookkeeping staff**

- **Manage and report on revenue and expenses**
- **Work with Treasurer**
- **Part of Finance Committee**
- **Support external auditor**

### **Board's responsibilities to the accounting and bookkeeping staff**

Mistakes happen and it is the responsibility of the Board Finance Committee to pay close enough attention to the reports from the accounting staff or external contractor to notice when things aren't quite right. Your Board Treasurer should have experience reading financial statements. If your Board of Directors does not have one person with this skill, it is your collective duty to train an existing Director or find a new Director to fulfill this role.

## Role of the external auditor

### **Role of external auditor**

- **Assess and report whether financial statements present financial position**

Your organization may be required to have an auditor to review its financial records. A BC Society is required to have an auditor if it is a "reporting Society" (check to see whether yours is), and a Society may be required by its bylaws to have an auditor (check your bylaws to be sure). The *Society Act* states that an auditor must report to the members at the annual general meeting. In that report, the auditor must state whether, in the auditor's opinion, the financial statements present fairly the financial position of the organization.

The old *Canada Corporations Act* required every federally-incorporated not-for-profit to have an auditor. Now, the *Canada Not-for-profit Corporations Act* creates different categories of not-for-profits with differing financial review obligations. A soliciting corporation is one with revenues from government sources of donations in excess of a specified amount; it is required to have its financials reviewed by a public accountant. A corporation which is not a soliciting one may also be required to have an audit, depending upon the size of its annual revenues. Whether a full audit is required, or simply a review engagement will depend upon several factors – make sure you know which type of review is required of your federal not-for-profit.

### **Auditor's responsibilities to the Board**

The auditor should advise the Board of any problems, and help the Board by answering questions about the financial statements of the organization.

### **Board's responsibilities to the organization**

The Board's principal obligations are those the Directors owe to the organization itself. Those duties are discussed in the following section.



## 5. Governance issues

### Duties of Directors

Because Board members have a great deal of control over the operations and management of the not-for-profit they volunteer with, the law imposes on them strict duties and obligations. Understanding and meeting these legal duties of Directors is critically important and will help ensure that most potential problems are dealt with at an early stage.

Although understanding and fulfilling the duties of Directors is a serious matter, it's not something that well-intentioned people need to worry about, as Hugh M. Kelly advises in his book, *Duties and Responsibilities of Directors of Not-for-profit Organizations*:

A Director who acts honestly and meets these standards of conduct and care will not be liable for simple errors of business judgment that occur while the Director performs the duties of the office.

#### **Duty of Care**

The Duty of Care – which has a particular legal meaning – has been captured in the BC Society Act, which states in section 25:

- (1) A Director of a society must:
  - (a) act honestly and in good faith and in the best interests of the society, and
  - (b) exercise the care, diligence and skill of a reasonably prudent person, in exercising the powers and performing the functions as a Director.

#### **Governance issues**

- **Board Directors control operations and management**
- **Must understand and meet common law duties and obligations**
- **Address problems early**

#### **Duties of Directors**

##### **Duty...**

- **of care**
- **of skill and prudence**
- **of knowledge**
- **of diligence**
- **to manage**
- **to act within scope of authority**
- **to avoid conflicts of interest**

The Cooperative Association Act uses virtually identical language, in s.84., to describe the duties of co-op Directors. The equivalent wording in the Canada Not-for-profit Corporations Act is to be found in section 148.

This general statement of a Director's duties can be subdivided into a number of more specific duties, as described below.

### **Duty of skill and prudence**

Very closely related to the duty of care, the duty of skill and prudence requires Directors to be thoughtful, cautious and to apply foresight to courses of action, acting always in the best interests of the organization.

### **Duty of knowledge**

The duty of knowledge requires Directors to learn as much as possible about the organization: to study the incorporation documents, bylaws, policies, past minutes, history, plans, and important issues.

### **Duty of diligence**

Duty of diligence means Directors must do their homework, be prepared, attentive and active. Directors should attend meetings regularly, raise questions and add value to discussions and deliberations.

### **Duty to manage**

The membership of the organization relies upon the Board of Directors to manage the business of the organization. In some organizations Directors must do this themselves, and in other cases Directors can delegate to Officers and staff. Either way, the Directors have a duty to ensure that the organization is managed properly.

### **Duty to act within scope of authority**

Charities and not-for-profit organizations are limited by the law to doing just those things for which they are authorized in the objects or purposes set out in their incorporation documents. It is unlawful for them to stray beyond these bounds. It is important for Directors to reference back to their purposes or objects each time a new proposal or opportunity comes before them, since it is not uncommon for an organization to drift in this regard over time.

Equally, the directors should turn their minds to these purposes and incorporating documents in a thoughtful way. The Canada Not-for-profit Corporations Act is very explicit about this responsibility, stating in section 148 (3) that "every director of a corporation shall verify the lawfulness of the articles and purpose of the corporation".

### **Duty to avoid conflicts of interest**

Directors must be very careful to not benefit or profit from their position as Director at the expense of the organization. To be in a position to do so is a conflict of interest, which must be disclosed to the other Directors.

A Director in a conflict of interest must not participate in or attempt to influence the organization's decision-making on the issue in question.

Directors of charities and not-for-profit organizations are subject to the same fiduciary duties that apply to Directors of for-profit enterprises. Fiduciary duties arise from trust law, and they apply to situations where one person holds power over another in a trust relationship. Fiduciaries must act in the utmost good faith, confidence, candour, honesty and loyalty to the organization.

Acting honestly, in good faith and in the best interests of the organization goes a very long way to avoiding potential liability. Of course, sometimes Directors may find they have competing interests or a duality of interests, if they work in an associated area. The most critical factor is to state those interests so that they can be examined by other Directors and the Board can make a properly informed ruling on the right course of action.

## Board management

### **Who is in control?**

By law, the Board of Directors is the ultimate authority and governance body of a not-for-profit organization. However, in practice this is often not the case. As noted in the section on Duties of Directors, the responsibilities of a Board member must be taken seriously. Acting as a so-called "rubber-stamp" Board – with directors who simply agree with whatever the Executive Director proposes without due diligence – is not an acceptable practice. It is good practice for your organization to have a Board attendance policy, including an expectation that a director who misses too many meetings without good reason may be removed.

Although it's not a comfortable subject to broach, it is one that should be evaluated within every organization from time to time. Look closely at where the *de facto* control of your organization lies: is it with the full Board, a sub-committee of the Board (that may or may not include staff) or is it with executive staff? Some warning signs that the full Board is not in control of the organization is if Board meetings are generally only attended by a small number of the same members. If this is the case with your not-for-profit, it should be addressed.

In some situations where a not-for-profit has a very active membership, the Board's authority may not be acknowledged or recognized. This situation most often arises in one of two situations: 1) organizations with long-time members who see themselves as the real advocates for the cause and who see the Board as a necessary evil; and 2) not-for-profits that don't involve the community that the organization serves (the people who benefit from the programs) in the election of the Board. If on reflection you find that this is true for your organization the situation should be addressed.

### **Board management**

#### **By law:**

- **ultimate authority and governance body**

#### **In practice:**

- **may not be the case**

If the organization is a federal not-for-profit, its members may have the right to restrict the Board's powers to manage or supervise, by entering into a unanimous member agreement. If there is such an agreement, the members assume the rights, powers, duties and liabilities of a director of the corporation, and the directors are relieved of their rights, powers, duties and liabilities to the same extent.

Sometimes a lack of understanding about who has authority for certain decisions can blur the lines of who is actually in control of a not-for-profit. For instance, the executive staff may decide to write and implement policies that will be beneficial to the health of the organization, and the Board may or may not be made aware of the policies, particularly if the policies refer to day-to-day operations – something the Board does not typically get involved in. This, however, is not an acceptable practice. All policies should come from the Board or at very least, be approved by the Board since policies become part of the official expression of principles that direct your organization's operations – which are a clear Board responsibility.

Finally, being in control of the governance of a not-for-profit requires each Board member to be informed about the history of the organization. Attaining an appropriate level of understanding requires first that Directors are given the necessary information by the Executive Director, and then, that they actually read and digest it all! When agreeing to become a Director, individuals should be given an information package that includes the following documents – and, Directors should be able to access this information at any time during their tenure as a Board member.

- Board minutes from the previous two years
- Financial statements from the previous two years
- Copies of program and service evaluations from the previous two years (this could be in the form of reports to major funders and government contractors)
- Annual Reports for the previous two years
- Auditor's Reports for the previous two years
- A copy of the Constitution and Bylaws (or equivalent)
- A copy of all policies in place
- A copy of the organization's current strategic plan and goals
- An organization chart
- Summaries of all programs/services
- A list of key staff and their positions
- A job description for each Board position

### **Choosing new Board members**

A Board needs a range of skills to perform its duties most effectively. Its members also need the time and energy needed to fulfil their responsibilities properly. Here are a few things to consider when recruiting new Board members:

- Professional skills (accounting, legal, etc.). Although professionals who sit as Directors usually cannot provide advice to the Board due to conflict of interest issues, having members with this expertise can be invaluable when discussing financial or legal matters;
- Sector-specific skills and experience;
- Availability to attend meetings (consider whether you can take measures to enhance this by, for example, providing child care to parents who might otherwise be unable to attend meetings);
- People skills: remember a Board is composed of individuals who must be able to work together;
- Possible conflicts of interest;
- Succession planning: new members should be brought on regularly and given a chance to learn so they can move into more responsible roles later; and
- Diversity: if some community sectors are not represented on your Board, consider ways to encourage greater participation.

#### **Choosing Board members**

- **Professional skills**
- **Sector-specific skills**
- **Availability**
- **People skills**
- **Possible conflicts of interest**
- **Succession planning**
- **Diversity**

## Reducing Board liability

Serving as a Director on the Board of a co-op or not-for-profit organization is one of the best ways to contribute to your community, but it is a serious undertaking that can expose an individual to liabilities. Accepting the responsibility should be made with understanding of how to fulfill the duties of a Director properly.

Liabilities for Directors can take many forms. For example, a Director could be found criminally liable for a fraud committed by the organization if the Director allowed it to happen. Similarly, a Director could be found civilly liable if he or she authorized a wrongful act that harmed someone. There are also potential statutory liabilities under corporate, tax, employment, environmental and other legislation. Cases of Director liability are rare in the not-for-profit world, but do occur.

There are several steps a Director can take to avoid personal liability.

- Ensure your organization carries appropriate and sufficient Directors and Officers liability insurance to protect both the organization and the Directors against damage, loss, or injury;
- Review Directors and Officers liability insurance annually to ensure it is still adequate and appropriate to the needs of the


#### **Reducing Board liability**

- **Be informed**
- **Maintain documentation**
- **Understand and manage personal liability**

- organization;
- Seek independent advice on issues beyond the Board's knowledge;
- Seek ratification of Board decisions by the membership;
- Disclose all conflicting or competing interests a Director may have in relation to the organization;
- Ensure any direct or indirect remuneration or other financial benefits Directors receive from the organization are not in contravention of their fiduciary duties;
- Establish a comprehensive due diligence review procedure;
- Establish a "Legal Risk Management" committee;
- Ensure Board members attend meetings and stay apprised of ongoing operational decisions, and do not delegate too much responsibility to executive staff;
- Include non-Board members on committees to reduce the number of Directors required to fulfill all duties, and keep Board members' commitments manageable;
- Establish an Advisory Board to complement the work of the Board.

Directors cannot be expected to have expert knowledge of all matters affecting the co-op or not-for-profit. Generally, they will have a defence against liability if they acted reasonably and in good faith, including good faith reliance on financial statements presented by an auditor or officer, or





on a report from a professional.

## 6. Meetings of members

Your not-for-profit or co-op must hold a meeting of its members at least once a year. For BC Societies, the *Society Act* sets out certain rules regarding notice, quorum, location of meetings and use of proxies. For example:

- Members should be given 14 days' written notice of meetings (although they may waive this requirement by unanimous written consent);
- Quorum for member's meetings is three members, unless the bylaws set the number higher;
- Proxies are only valid for one meeting;
- Meetings must be held in British Columbia unless the Registrar gives permission for a meeting to be held outside the province.

Similar rules for federally incorporated not-for-profits can be found in the *Canada Not-for-profit Corporations Act*. You should also check the provisions of your bylaws carefully, as they will contain further rules about how meetings are to be conducted. They may set a higher quorum, or forbid the use of proxies, or specify how notice may be given or voting may be conducted.

### Annual meetings

The Annual General Meeting ("AGM") is the most important opportunity for members to ensure accountability of the Board. At the AGM, typically, members review the annual financial statements, elect Directors, (sometimes) appoint auditors and vote on any changes to the constitution and bylaws.

#### Meetings

##### Annual Meetings

- **Proper timing**
- **Ensure Board accountability**
- **Review annual statements**
- **Elect Directors**

##### Special Meetings

- **Deal with matters that come up**

The *Society Act* requires that an AGM be held at least once in each calendar year, and no more than 15 months following the previous AGM. It also requires that the Directors provide the members with the following information:

- Annual financial statements;
- The auditor's report, if the Society has an auditor;
- The report of the Directors to the members; and
- Any further information the bylaws of the Society may require it to provide to the members.

The federal not-for-profit legislation also regulates the timing of meetings and the information that must be provided to members.


The *Cooperative Association Act* also contains, in s.8.1 of the Act, a number of rules about meetings. In general terms, they are similar to the provisions in the *Society Act*.

## Special meetings

A special meeting (or special general meeting, "SGM") is a general meeting of members other than an AGM. You may wish to call a special meeting to deal with important matters requiring member approval which arise between AGMs. The Directors can call a meeting at any time, as long as they follow the proper notice procedures. The *Society Act* also provides that the Directors must call a meeting of the members, if they receive a requisition from 10% or more of the voting members.

For co-ops, the number of signatures needed to requisition a meeting will depend upon the number of members: the larger the co-op membership, the lower the percentage needed to requisition a meeting. Thus if the co-op has 100 members or fewer, 20% are needed, but this drops to 5% if there are at least 5,000 members.

Under the *Canada Not-for-profit Corporations Act*, the percentage of members required to requisition a special meeting may be set in the corporation's bylaws provided that the percentage required is no greater



than 5%.

## 7. Fundraising

All Board members have responsibilities related to the fundraising activities of the not-for-profit they govern. In addition to donating their time and expertise, they should normally be making a financial contribution to the organization. Although there is no legal requirement to do so, it is absolutely in the best interest of the organization for staff to be able to say with all honesty that “One hundred percent of our Board financially support this organization” when they are seeking support from the community, foundation funders and government supporters.

Most Boards will establish a fundraising committee and the responsibilities of those members will also include ensuring all of the organization’s fundraising activities follow the ethical guidelines established in Canada by either (or both) the Canadian Association of Fundraising Professionals or Imagine Canada.

### Operating outside British Columbia

A not-for-profit that undertakes fundraising activities in provinces other than British Columbia may be required to register as an extra-provincial corporation and/or fundraiser in the provinces in which it is operating. Fundraising in Quebec requires obtaining Quebec charitable status.

#### Board members and fundraising

- **Responsibility to support fundraising**
- **Making financial contributions**
- **Establish a fundraising committee**
- **Ensure ethical guidelines are followed**

#### Operating outside BC

- **May be required to register as extra-provincial entity**
- **Can only make grants to qualified international agencies, as defined in Income Tax Act**

## Fundraising legislation

- **Personal Information Protection Act (PIPA)**
- **Society Act**
- **Gaming**
- **Other licensing requirements**
- **The Income Tax Act**
- **Split-receipting**
- **Anti-tax shelter provisions**

# Provincial and federal fundraising legislation

In British Columbia there are several laws and rules that may affect not-for-profit and charitable fundraising activities.

## **Personal Information Protection Act**

This Act, known as PIPA, relates to privacy legislation and states (among other things) that all organizations must obtain consent before gathering and using information about individuals for fundraising purposes.

## **Society Act**

Although this statute doesn't specifically deal with fundraising, it requires that, unless its constitution or bylaws provide otherwise, all funds held by a not-for-profit be invested in particular types of investments permitted by the Trustee Act. It also requires that Societies keep proper accounting and financial records.

## **Gaming**

If your not-for-profit wishes to raise funds through casinos, raffles, bingo or other gambling activities, you will need to apply for the appropriate gaming licence from the Gaming Policy and Enforcement Branch of the Ministry of Finance

## **Other licensing requirements**

Fundraising may take many forms, and each activity will be governed by specific rules and regulations. If your organization is raising funds by selling hot dogs, for instance, you'll probably need to comply with food safety regulations. If you have volunteers soliciting funds door-to-door, or using the services of commercial fundraisers, other regulations will apply. It's impossible to list all the possible applicable rules, so seek legal advice before embarking on a new fundraising activity.

## **The Income Tax Act**

The Income Tax Act has detailed rules applicable to charities, including rules about the information that must be stated on charitable receipts given to donors. These are discussed in more detail later in this workbook. Both charities and other not-for-profits should keep careful records of fundraising, in the event of an audit by the Canada Revenue Agency.

## Donor's rights

Donor's rights are addressed in detail in Imagine Canada's Ethical Fundraising and Financial Accountability Code and in the Donor Bill of Rights produced by the Association of Fundraising Professionals. Both are available free-of-charge on the organizations' websites.

The Canada Revenue Agency also has a valuable section of their website which provides information for donors, such as what to look for on donation receipts, answers to questions about giving to charities, and how charities are regulated in Canada.

### Donor's rights

- **Ethical Fundraising Code**
- **Donor Bill of Rights**
- **Canada Revenue Agency**

## Sponsorships

When considering sponsorship arrangements as a means of fundraising, not-for-profits and co-ops should seek legal advice about what a sponsorship agreement should contain. Contracts should set out clearly the obligations of both sides – what is the sponsor getting in exchange for its contribution? What happens if one party wishes to end the arrangement, or if something goes wrong? Charities should also note that sponsorship funds are not considered donations, so tax receipts cannot be given for them.

### Sponsorships

- **Seek legal advice**
- **Have clear contracts**


## Joint venture agreements

A joint venture agreement is one in which two or more entities pool their resources to work on a project. Not-for-profits may wish to take part in collaborative activities with other agencies or organizations, and it's very important that such activities be carefully monitored and properly structured. If funds are being provided by a charity to a body that is not a "qualified donee" in Canadian tax law, it is essential that the charity has a properly worded contract with that body so that the charity can show the CRA, in the event of an audit, that it has direction and control over the collaborative activities and that the funds were spent on charitable activities. If the Canadian charity is simply giving funds to a foreign charity, for instance, without having much control over the project, CRA may conclude that this does not qualify as the Canadian charity carrying on its own charitable activities.

### Joint ventures

- **Pool resources for a project**
- **Collaborate with other agencies or organizations**
- **Must be carefully structured and monitored**





## 8. Special legal responsibilities of charities

Canada does not have a national Charities Act with a comprehensive definition of charity. Instead, we have a common law concept of charity, which says that a charity is an entity with purposes falling within one of the “four heads of charity”. These are:

1. the relief of poverty;
2. the advancement of education;
3. the advancement of religion; or
4. other purposes beneficial to the community in a way the law regards as charitable.

Given how vague the fourth category is, charities can sometimes find themselves operating outside of the law. It is a Board member’s duty to ensure that your organization does not find itself in this situation! The best way to do this is to review your programs and activities on an annual basis and compare these to the charitable objects that were set-out in your original application to the Charities Directorate.

The CRA provides the following list of basic guidelines for maintaining charitable status. At a minimum, you should be aware of when and how

### Legal concept of charity

#### Four heads of charity:

1. **Relief of poverty**
2. **Advancement of education**
3. **Advancement of religion**
4. **Other community purposes**

#### Special legal responsibilities

1. **Engaging in allowable activities**
2. **Keeping adequate books and records**
3. **Issuing complete and accurate receipts**
4. **Meeting annual spending requirements**
5. **Filing an annual T3010 return**
6. **Maintaining charity’s status as legal entity**
7. **Changing mode of operation or legal structure**
8. **GST/HST sales tax checklist**
9. **“Political activities” and participating in public policy debate**
10. **Related business activities**
11. **Operating outside BC**

your charity is meeting these requirements.

## Engaging in allowable activities<sup>2</sup>

### Allowable activities

- **Devote resources to charitable activities**
- **Maintain direction and control over activities**

A registered charity must be created for exclusively charitable purposes and must devote its resources (funds, personnel, and property) to charitable activities. A registered charity is permitted to carry out its charitable purposes, both inside and outside Canada, in only two ways: by carrying on its own charitable activities, and by gifting to qualified donees.

A registered charity must maintain direction and control over its activities (whether carried out by the charity, or by an agent or contractor on its behalf) and must not engage in prohibited political activities or unrelated business activities. Determine if your charity is aware of the following requirements:

- Contact the Charities Directorate if the charity plans to engage in new activities that were not identified in its application for registration, to ensure they qualify as charitable.
- Limit using the charity's resources for social activities and fundraising activities as they generally are not considered charitable.
- If working through intermediaries such as an agent, a contractor, or any other non-qualified donee, the charity must be able to demonstrate that it retains direction and control over the use of its resources (for example, the charity could enter into a formal written agreement with the intermediary body.)
- Do not engage in any prohibited political activities, such as supporting or opposing a political party or candidate for public office.
- Gift only to qualified donees (for example, other registered charities).
- Engage in only related business activities that accomplish or promote the charity's purposes, if the charity is designated as a charitable organization or a public foundation.
- Do not engage in any business activities if the charity is designated as a private foundation.

---

<sup>2</sup> For more information about allowable activities, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/ctvts-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/ctvts-eng.html)



## Keeping adequate books and records<sup>3</sup>

A registered charity must keep adequate books and records in either English or French, for the prescribed time period, at an address in Canada that is on file with the Canada Revenue Agency (CRA). The following checklist gives an overview of the general requirements. Ensure the books and records of the charity are kept as follows:

- Copies of official donation receipts (other than for 10-year gifts) kept for a minimum of two years from the end of the calendar year in which the donations were made.
- All records concerning 10-year gifts kept for as long as the charity is registered and for a minimum of two years after the date the registration of the charity is revoked.
- Minutes of meetings of the Directors/trustees/executives kept for as long as the charity is registered and for a minimum of two years after the date the registration of the charity is revoked or, in the case of a corporation, for two years after the day the corporation is dissolved.
- Minutes of meetings of the members kept for as long as the charity is registered and for a minimum of two years after the date the registration of the charity is revoked.
- All governing documents and bylaws kept for as long as the charity is registered and for two years after the date the registration of the charity is revoked.
- General ledgers or other books of final entry containing summaries of year-to-year transactions and the vouchers and accounts necessary to verify the entries kept for six years from the end of the last tax year to which they relate, for as long as the charity is registered, and for two years after the date the registration of a charity is revoked or, in the case of a corporation, for two years after the day the corporation is dissolved.
- Financial statements, source documents, and copies of T3010 returns kept for six years from the end of the last tax year to which they relate or, if the charity is revoked, for two years after the date of revocation. Source documents may include items such as invoices, vouchers, formal contracts, work orders, delivery slips, purchase orders, or bank deposit slips.

### Keeping records

- Receipts
- Records
- Minutes
- Governing documents
- Ledgers
- Financial statements
- Back-up copies

---

<sup>3</sup> For more information about books and records, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/bks-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/bks-eng.html)

## Notes

- The charity should keep all its key documents (constitution, bylaws, registration letter, etc.) along with its books and records in one area for easy access. This will make it easier for the charity in the case of an audit or when there is a change to the governing Board.
- Copies of key documents and records should also be kept in a separate location (preferably off-site) for back-up purposes.

## Issuing complete and accurate donation receipts<sup>4</sup>

### Issuing receipts

- **Gifts of cash**
- **Non-cash gifts**

A registered charity may only issue official receipts for donations that legally qualify as gifts. An official receipt must contain all the information specified in Regulation 3501 of the *Income Tax Act*. The donation receipts of the charity must contain these mandatory elements:

- For gifts of cash:
  - a statement that it is an official receipt for income tax purposes;
  - the name and address of the charity as on file with the CRA;
  - the charity's registration number;
  - the serial number of the receipt;
  - the place or locality where the receipt was issued;
  - the day or year the donation was received;
  - the day on which the receipt was issued if it differs from the day of donation;
  - the full name and address of the donor;
  - the amount of the gift;
  - (under proposed legislation) the value and description of any advantage received by the donor;
  - (under proposed legislation) the eligible amount of the gift;
  - the signature of an individual authorized by the charity to acknowledge donations; and
  - the name and Web site address of the Canada Revenue Agency ([www.cra.gc.ca/charitiesandgiving](http://www.cra.gc.ca/charitiesandgiving)).
- For non-cash gifts (gifts in kind), these additional elements:
  - the day on which the donation was received (if not already indicated);

---

<sup>4</sup> For more information about donation receipts, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/rcpts-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/rcpts-eng.html)

- a brief description of the property transferred to the charity;
- the name and address of the appraiser (if property was appraised); and
- (under proposed legislation) in place of the amount of the gift mentioned above, the deemed fair market value of the property.

**Note**

For gifts in kind, the eligible amount of the gift cannot exceed the deemed fair market value of the item. An appraisal is recommended for items valued at \$1,000 or more. A registered charity cannot issue receipts for the following:

- for contributions of services provided to the charity (services do not qualify as gifts);
- on behalf of another organization or charity;
- in a name other than the name of the true donor.

**Split-receipting<sup>5</sup>**

When a registered charity provides a donor with something of value in return for making a donation, this is considered a benefit, which is called an advantage. The advantage generally reduces the eligible amount of the donation for income tax purposes and will be indicated on the donor's official donation receipt.

For example, you donate \$1,000 to the Anytown Ballet Company, which is a registered charity. In gratitude, the company provides you with three ballet tickets worth \$50 each, for a total value of \$150. These tickets are considered an advantage of \$150. The eligible amount of your donation for calculating your tax credit is therefore \$850 (\$1,000 - \$150).

**Anti-tax shelter provisions<sup>6</sup>**

The Canada Revenue Agency is reviewing all tax shelter-related donation arrangements (for example, schemes that typically promise donors tax receipts worth more than the actual amount of the donation), and it plans to audit every participating charity, promoter, and investor.

For audits completed to November 2008, over 65,000 Canadian taxpayers who participated in these schemes had been reassessed, or were in the process of being reassessed. In most cases the CRA has denied the "gift" completely with over \$2.5 billion in claimed donations having been denied.

For more information about tax shelters, go to the CRA's tax alert webpage at [www.cra.gc.ca/alert](http://www.cra.gc.ca/alert).

---

5 For more information about split receipting, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/rcpts/splt-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/rcpts/splt-eng.html)

6 For more information about tax shelters, visit the CRA's tax alert webpage at [www.cra.gc.ca/alert](http://www.cra.gc.ca/alert)

## Meeting annual spending requirements (disbursement quota)<sup>7</sup>

### Annual spending requirements

- **Must spend minimum calculated for its disbursement on charitable activities**
- **Sum total of five calculations**

A registered charity must spend the minimum amount calculated for its disbursement quota each year on its own charitable activities, or on gifts to qualified donees (for example, other registered charities). The charity should check that it is able to meet its spending requirement:

- Estimate the charity's annual spending requirement at the start of the fiscal period. Refer to the Registered Charity Information Return Summary issued for the prior year information return when it is received.
- If applicable, make note of any prior year disbursement quota shortfalls that need to be made up or any excesses that may be applied to meet the current year's spending requirement.
- Separate charitable expenditures from other expenditures such as management and administration, political activity, and fundraising and keep track of these throughout the fiscal period as well as amounts gifted to qualified donees.
- Enter the proper amounts on line 5000 (charitable expenditures) and on line 5050 (gifts to qualified donees) when completing the T3010B return.
- Consider requesting permission to accumulate funds or a disbursement quota reduction if appropriate.

The annual spending requirement, or disbursement quota, is based upon a percentage of the value of the charity's property which is not used for charitable activities or administration.]

## Filing an annual T3010 information return<sup>8</sup>

A registered charity must file an annual information return (together with financial statements and required attachments) no later than six months after the end of the charity's fiscal period. The charity should check to include:

---

<sup>7</sup> For more information about disbursement quotas, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/dqb-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/dqb-eng.html)

<sup>8</sup> For more information about filing a T3010, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/prtnng/rtrn/menu-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtnng/rtrn/menu-eng.html)

- Form T3010-1, Registered Charity Information Return;
- Form TF725, Registered Charity Basic Information sheet;
- Form T1235 (09), Directors/Trustees and Like Officials Worksheet (not required if filing Form RC232-WS);
- Form T1236 (10), Qualified Donees Worksheet / Amounts Provided to Other Organizations (if applicable);
- Form T2081 (10), Excess Corporate Holdings Worksheet for Private Foundations (if applicable);
- the registered charity's own financial statements (even if the charity was not active).

**Filing annual T3010 return**

- **Must file with financial statements and required attachments no later than six months after end of fiscal period**

If a registered charity does not file its annual information return within six months after the end of its fiscal period, its registration could be revoked. Revocation is when a charity's registration is cancelled and the privileges that go with it are taken away. When a charity's registration is revoked it:

- will have its name and the reason for its revocation posted in Part 1 of the Canada Gazette and in the online list of revoked charities on the Charities and Giving Web pages;
- cannot issue official donation receipts;
- no longer qualifies for exemption from income tax as a registered charity; and
- must transfer all its remaining property to an eligible donee or be subject to a revocation tax equal to the property's full value.

Registered charities are generally given a chance to avoid revocation.

- A computer-generated reminder (TX11D, Reminder to Registered Charities to File Return) is sent to the charity if CRA does not receive the annual return within three months after the end of the charity's fiscal period.
- An email reminder will be sent four months after the end of the charity's fiscal period, if the charity has provided CRA with an email address.
- A T2051A, Notice of Intention to Revoke a Charity's Registration is sent to the charity by registered mail if CRA does not receive the annual return within seven months after the end of the charity's fiscal period.
- Eight months after the end of the charity's fiscal period, CRA may try to contact representatives of the charity by telephone to remind them again to file the annual return.
- Ten months after the end of the charity's fiscal period, CRA will send the charity a T2051B, Notice of Revocation of Charity's Registration that sets out the effective date of revocation and includes Form T2046, Tax Return Where Registration of a Charity is Revoked.

A charity that loses its registration because it did not file its annual information return on time is subject to a non-refundable \$500 penalty, assessed when an application for re-registration is made.

## Changing the charity's mode of operation or legal structure<sup>9</sup>

### Changing mode or structure

#### Contact Charities

##### Directorate to:

- **Ensure changes qualify as charitable**
- **Obtain approval before fiscal period end**

If the charity is anticipating change in structure, it should contact or notify the Charities Directorate in the following circumstances:

- to ensure any proposed changes to the charity's objects or proposed changes to the charity's objects or activities qualify as charitable;
- to obtain approval before making a change to the charity's fiscal period end;
- For gifts of cash:
  - permission to accumulate funds,
  - a re-designation,
  - associated status, or
  - a disbursement quota reduction;
  - if the charity has changed its name, address, telephone or fax numbers, email address, or contact information and has not already identified the change(s) on the Registered Charity Basic Information sheet;
  - if the charity has changed its governing documents (constitution, articles of incorporation, etc.);
  - if the charity has been part of an amalgamation, merger, or consolidation;
  - if the charity is no longer in operation and wishes to have its registration voluntarily revoked.

## Goods and services tax checklist for charities<sup>10</sup>

The purpose of this checklist is to help charities understand their GST obligations and entitlements. As a Director, you should be aware of whether the organization you support is eligible for GST rebates.

- Determine if your organization is a charity for GST purposes. A registered charity for income tax purposes is also a charity for GST purposes. However, a charity for GST purposes does not include a public institution (that is, a registered charity that is a school authority, a public college, a university, a hospital authority, or a local authority determined to be a municipality).

<sup>9</sup> For more information about this topic, visit, [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/chngs-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/chngs-eng.html)

<sup>10</sup> For more information about GST, visit [www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/gsthst-cfc-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/gsthst-cfc-eng.html)

- Determine if your charity is making taxable supplies. The tax status of your charity's supplies (for example, its sales, leases, rentals, and services) has to be determined. While most of a charity's supplies are tax-exempt, some of its supplies may be taxable.
- Calculate the small supplier tests. Small supplier tests are used to determine if your charity must register for GST purposes. Charities have two small supplier tests — the \$250,000 gross revenue test and the \$50,000 taxable supplies test. Gross revenue includes business income, donations, grants, gifts, property income, and investment income, then subtract any amount considered a capital loss for income tax purposes. To calculate taxable supplies for the purposes of the second test, add worldwide revenues from supplies of goods and services subject to GST, including zero-rated supplies. Do not include sales of capital property, supplies of financial services, or certain payments for goodwill. A charity is considered a small supplier if it has either \$250,000 or less in annual gross revenue or not more than \$50,000 in annual worldwide taxable supplies.
- Determine if your charity is required to register for GST. If your charity makes taxable supplies, it may have to register for GST. A charity that is a small supplier does not have to register for GST, but it may do so voluntarily. Charities that are not small suppliers must register for GST.
- Determine if your charity is required to collect GST on its taxable supplies. If your charity is registered or required to be registered for GST, it is required to collect 5% GST or HST at the rates applicable in the province or territory where the supplies are made.
- Complete GST returns if your charity is registered for GST. If your charity is registered for GST, ensure that GST returns are filed and calculations are done correctly. Most charities that are registered for GST have to file a return once a year using the “net tax calculation for charities.” A charity that uses this method remits 60% of the GST it collects on most of its taxable supplies, and it must not claim input tax credits for the GST paid on most purchases.
- Apply for the public service bodies' rebate. Regardless of whether your charity is registered for GST, it is generally entitled to claim a 50% public service bodies' rebate of the GST and the federal part of the HST it paid on its purchases. A public service bodies' rebate

#### **GST checklist**

- **Understand obligations**

is also available to charities resident in a participating province on the provincial part of HST at the applicable provincial rate.

- Establish eligibility for other GST rebates. Your charity may be entitled to other GST rebates, including rebates of the GST paid on printed books, expenses related to providing rentgearedtoincome housing, goods and services exported outside of Canada, and goods and services removed from the participating provinces.
- Maintain adequate books and records. Generally, your charity must keep all records and supporting documents, used to determine its GST obligations and entitlements for a period of six years from the end of the year to which the records/documents relate.

More information on charities and the GST can be found in Guide RC4082, GST/HST Information for Charities.

## Operating outside Canada

Canadian charities engaging in international work cannot simply grant funds to similar organizations based in other countries, even if those organizations are recognized as charities by the governments of other countries.

Canadian charities may only make grants to international agencies that meet the “qualified donees” test as defined in the federal *Income Tax Act*. These are:

- the United Nations or its agencies;
- prescribed universities outside Canada (listed in Schedule VIII of the *Income Tax Act*);
- charitable organizations outside Canada to which Her Majesty in right of Canada (the federal government or its agents) has made a gift during the previous 24 months; or

Otherwise, Canadian charities must do the international work themselves, retain an agent or hire a contractor to do the work on the charity’s behalf. Another option is to participate in a joint venture or co-operative partnership as defined by the Charities Directorate in the publication CG-002 – Canadian Registered Charities – Carrying Out Activities Outside Canada.

CG-002 sets high standards and provides detailed guidance as to how Canadian charities should structure, document and monitor international work. The public policy concern behind these standards is to ensure that the resources of Canadian charities are properly used for work considered charitable under Canadian law and to protect against possible misuse and abuse of these tax-assisted resources. All charities engaged in or considering work outside Canada should become very familiar with CG-002.



## Political activities

A registered charity cannot be created for a political purpose and cannot be involved in partisan political activities. A political activity is considered partisan if it involves direct or indirect support of, or opposition to, a political party or candidate for public office.

However, a registered charity may take part in limited political activities if they are non-partisan and connected and subordinate to the charity's purposes. A connected activity relates to and supports a charity's purposes and represents a reasonable way to achieve them. A subordinate activity is subservient to a charity's dominant charitable purpose or is a minor focus of the charity.

An activity is considered to be political if it:

- encourages the public to contact elected representatives or public officials to urge them to retain, oppose, or change any law, policy, or decision in any jurisdiction;
- communicates to the public that the law, policy, or decision of any level of government in any jurisdiction should be retained, opposed, or changed;
- attempts to incite or organize the public to put pressure on elected representatives or public officials to retain, oppose, or change any law, policy, or decision of any level of government in any jurisdiction; or
- attempts to sway public opinion on social issues.

A registered charity can devote part of its resources to political activities provided substantially all of its resources are devoted to charitable activities. As a general rule, CRA considers a charity that devotes no more than 10% of its total resources a year to political activities to be operating within the substantially all requirement.

However, CRA recognizes that this administrative guideline may have a negative impact on smaller charities. Therefore, the following thresholds will apply:

- Registered charities with less than \$50,000 annual income in the previous year can devote up to 20% of their resources to political activities in the current year.
- Registered charities whose annual income in the previous year was between \$50,000 and \$100,000 can devote up to 15% of their resources to political activities in the current year.
- Registered charities whose annual income in the previous year was between \$100,000 and \$200,000 can devote up to 12% of their resources to political activities in the current year.

For a detailed explanation of political activities, see Canada Revenue Agency document CPS-022, Political Activities. CRA has also created a number of web pages to provide guidance about charities and political activities – check the CRA website.

If a charity makes a gift to another qualified donee, and it can reasonably conclude that the purpose is to support the political activities of the donee, the gift will be considered a political activity of the donor. This applies only to gifts made after June 29, 2012.

## Related business activities

Another area to be closely considered is the trend towards business activity by charities.

The federal government's treatment of this balance is found in CPS-019 – What is a Related Business? This policy guidance is quite complex but does provide examples of the types of enterprises the Charities Directorate will accept as “related business.” The guidance also confirms that charitable organizations (as opposed to foundations) can create and control for-profit taxable corporations to house business activities, the proceeds of which can flow to the charity to support its works.



## 9. The legal context for social enterprises

As the economic climate has become increasingly challenging for not-for-profits and charities, many have turned to social enterprise as a way of generating funds. Here's one definition of social enterprise:

Social enterprises are businesses operated by non-profits with the dual purpose of generating income by selling a product or service in the marketplace and creating a social, environmental or cultural value<sup>11</sup>

The rapid growth in the social enterprise sector creates numerous challenges, as well as opportunities, for not-for-profits who venture into this field. Many of those challenges have to do with management styles and business planning, but there are also important legal considerations to be kept in mind.

### Options for structuring social enterprises

Social enterprises can exist in a variety of traditional legal business structures, from sole proprietorships to traditional corporations. Some are established as co-operatives, others operate as programmes within the operations of larger not-for-profits or charities. Some are stand-alone entities while others are subsidiaries or are operated through joint ventures of other groups.

None of these traditional models is a perfect “fit” for social enterprise. A regular corporation exists principally (although not exclusively) to make profits for its shareholders, and the usual expectations of corporate directors are that they will not permit other purposes to interfere with the pursuit of profit.

---

11 For a broader discussion of what social enterprises are and do, visit [www.socialenterprisecanada.ca](http://www.socialenterprisecanada.ca)

On the other hand, charities must be established purely for charitable purposes, and generating profits is not recognised as a charitable purpose. Thus a charity is subject to many legal restrictions in its ability to operate a social enterprise, including prohibitions on compensating directors for serving on the board or distributing revenues to members. Furthermore, it is only permitted to engage in “related” business activities, as discussed later in this section.

The inability to issue shares or pay dividends makes it very hard for any not-for-profit to raise capital for business purposes.

Of these traditional legal structures, the ones best suited to social enterprise is the co-operative, which can issue dividend-paying investment shares and is permitted to pursue both revenue generation and social goals. Social goals and shared values are at the heart of the co-operative movement.

In British Columbia, a new form of corporation was introduced which should offer much greater scope for social enterprises. On June 29, 2013, a new section of the Business Corporations Act (British Columbia (the “BCBCA”) came into force. The new provisions permit the incorporation of “Community Contribution Companies” (sometimes called “CCCs”). These companies will in many respects be the same as traditional for-profit corporations, with a few key differences:

- One of its primary purposes must be a “community purpose”, defined in the BCBCA as a purpose beneficial to either (a) society at large, or (b) a segment of society that is broader than the group of persons who are related to the CCC. The list of purposes is not closed, and includes the purpose of providing health, social, environmental, cultural, educational or other services.
- The corporation must have the words “Community Contribution Company” or the abbreviation “CCC” as part of its name.
- The CCC must have at least three directors.
- Its directors and officers must act with a view to the community purposes of the company.
- The CCC is restricted in its ability to pay dividends or transfer assets.
- On dissolution, a certain percentage of the remaining assets of the CCC must be distributed to a charity or a community service cooperative.
- The directors of the CCC must produce and publish a report each year which sets out, among other things, how the activities of the CCC during the previous financial year benefited society. The report must be posted on the website of the CCC.

This model is based upon one introduced in the United Kingdom in 2005. The equivalent groups in the UK are called Community Interest Companies, “CICs”), and in the UK a special office has been established to regulate them.

British Columbia is the first jurisdiction in Canada to introduce such a legal structure for social enterprises, and the next few years will be an exciting time for social enterprises in the province.

### **Registered charities and business ventures**

A registered charity is permitted to raise funds through business or commercial activities if those activities constitute a “related business”. Carrying on an unrelated business could cause the charity to lose its charitable status, so this is an issue charities must think about carefully.

## How does CRA decide that a charity is carrying on a business?

It isn't always easy to draw a clear line between fundraising activities and operating a business. CRA has published some guidance to help when considering this matter. The guidance says that “business” means “commercial activity – deriving revenues from providing goods and services – undertaken with the intention to earn a profit.”

Here are the factors CRA considers, based on tests established in case law:

- The intended result - If the rationale for an activity is to generate profit, that activity is likely a business.
- The potential to show a profit - In determining whether a particular activity is a business, it is the intention and capacity to make a profit at some point that are relevant. If the activity is incapable of returning a profit, then it is not a business.
- The existence of profits in past years.
- The expertise and experience of the person or organization undertaking the activity - If that person or organization has been selected because of commercial knowledge, skill, or experience, that suggests the activity is a business.

In contrast, CRA says soliciting donations and selling donated goods are not business activities. Soliciting them isn't a business activity because donors don't expect anything in return, and selling them isn't a business because it is simply converting assets (donated goods) to a different form (cash).

Some fundraising activities are in the nature of business but only take place infrequently; in that case CRA says the charity is not “carrying on” a business as it isn't a continuous activity or a regular part of its day-to-day activities.

# Can you operate your business within your charitable organization?

A charity can only operate a “related business” within its charitable organization, and even then only if the related business is subordinate to the central functions of the charity. There are two kinds of related businesses:

1. Businesses that are run by volunteers; and
2. Businesses that are linked to a charity’s purpose and subordinate to that purpose.

CRA says “substantially all” means, as a general rule 90% or more. So it isn’t sufficient if most of those running the business are volunteers.

The second test is a bit harder to apply. The first part, that of being linked to the charity’s purpose, is a question of how directly the business is connected to the charity’s purposes. CRA policy describes four types of links:

1. The business is a usual and necessary concomitant of charitable programmes. Examples: museum gift stores, university bookstores or student residence.
2. The business is an off-shoot of a charitable programme. Example: a farm museum grows wheat and grinds it into grain which is sold.
3. The business is a use of excess capacity. Example: a church renting out, on weekdays, parking spaces which it maintains for use on Sundays by members of the congregation.
4. The business consists of selling items that promote the charity or its objects. Examples: t-shirts, posters, or souvenir items bearing the charity’s logo.

The second part of that test asks whether the business is subordinate to the charitable purpose. If the business becomes so important that it is effectively one of the purposes of the organization, then the organization is no longer one with exclusively charitable purposes. To answer that question one has to consider the business in the context of the charitable operations as a whole. The CRA guidance list four factors to be considered. If these four statements describe your situation, it is likely that CRA would consider the business to be subordinate:

1. Relative to the charity’s operations as a whole, the business activity receives a minor portion of the charity’s attention and resources.
2. The business is integrated into the charity’s operations, rather than acting as a self-contained unit.
3. The organization’s charitable goals continue to dominate its decision-making.
4. The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter in its operations.

### **What if your business is unrelated?**

If your business is not a related business, then your charity is required by law to set up a separate business entity. If a charity carries on an unrelated business within the other operations of the charity, it could lose its charitable status.

But revocation would not be the first option pursued by CRA. The charity would first be invited to wind-up the unrelated business or to place it in a separate taxable corporation. The charity would be expected to rectify the situation within a reasonable timeframe. If the charity established a separate taxable corporation, it could invest in the corporation on the same basis that it could invest in any other for-profit business. The charity's directors would need to satisfy themselves that the investment was a prudent use of the charity's assets.

## **Business as a charitable program – community economic development**

In some special circumstances CRA will consider business activities to be charitable. In 2012, CRA issued new guidance which expanded upon its previous statements about community economic development (“CED”) as a charitable purpose. CRA stated that CED could also be described as social enterprise, social finance, or community capacity building.

CED activities generally fall into five areas:

1. activities that relieve unemployment;
2. grants and loans;
3. program-related investments;
4. social businesses for people with disabilities; and
5. community land trusts.

Each of these must, to be charitable, further a recognised head of charity. For example, one head of charity is the relief of poverty. Programs to help relieve unemployment are not considered charitable if they are targeted at the general public, but they may be charitable if their purpose is to alleviate poverty by relieving unemployment of poor people.

Grants, loans and investments may qualify if certain specific criteria can be met, and it can be shown that the loan, grant or investment is clearly linked to one of the existing heads of charity. For example, a charity which provides social housing could buy shares in a for-profit housing corporation as part of a deal which required the for-profit entity to offer a number of units to poor people at below-market rents.

To further a charitable purpose, a social business must have the following characteristics:

- the workforce is composed entirely of individuals with disabilities, with the exception of employees who provide necessary training and supervision; and
- the work is specifically chosen and structured to take into account the special needs of individuals with disabilities and to relieve conditions associated with those disabilities.

•  
CED activities may be charitable if they improve socio-economic conditions for the public benefit in an area of social and economic deprivation. CRA defines areas of social and economic deprivation as geographic communities with high rates (at least 1.5 times the national average) of one or more of the following characteristics:

- unemployment for two or more consecutive years;
- crime, including family violence;
- health problems, including mental health issues, drug and alcohol addiction, and suicide; and
- children and youth at risk (taken into care or dropping out of school).

## Summary of social enterprise categories

CRA regards business activities of charities as falling within one of three categories:

1. Charitable programmes: this means that the activity is a charitable programme in its own right, because it furthers a charitable purpose.
2. “Related Business:” either run by volunteers, or linked to (and subordinate to) the purposes of the charity.
3. Unrelated business: not connected to the purpose of the charity.

## Legal structures for social enterprises

There are several different options for structuring a social enterprise – think carefully about the pros and cons of each when deciding how your organization wants to operate.

### **As a program or activity within the main organization**

If your business is not a related business, then your charity is required by This is usually not a problem if you are a co-op, but not permitted for a charity or other not-for-profit entity unless it is only a minor activity and related to its purposes.



**As a separate for-profit subsidiary**

This can offer much greater freedom to pursue business activities, as long as there is sufficient separation between the activities and resources of the parent and those of the subsidiary. There will, of course, be additional expenses associated with this option.

**As a separate not-for-profit**

This may be a good option in some limited circumstances, but a not-for-profit cannot be operated to generate a surplus, which is usually an important reason for setting up a social enterprise in the first place.

**As a co-operative**

A co-operative model is ideally suited to social enterprise because the co-op model is based upon notions of social values as well as revenue generation. If you want more information about co-operatives, take a look at the website of the British Columbia Co-operative Association.

**Joint ventures or partnerships**

Your entity may wish to join another in establishing or operating a social enterprise, whether in partnership or through a joint venture. These forms are not considered separate entities in law, so you will need to consider some of the same issues that arise when operating a social enterprise within your organization.