



MILLER THOMSON LLP

Barristers & Solicitors
Patent & Trade-Mark Agents



CHARITIES & NOT-FOR-PROFIT NEWSLETTER

August 2007

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

Inside

The *Best Lawyers* in Canada
Filing T3010s on a Timely Basis is Crucial

New Tests for Designation of Charities

When the IRS Steps Into Governance, Can CRA be Far Behind?

Charitable Gaming

Manitoba Tax Break for Hiring Co-op Students and Graduates

What's Happening Around Miller Thomson LLP

THE BEST LAWYERS IN CANADA

The *Best Lawyers* in Canada Directory was published in the July/August 2007 Financial Post Business Magazine. Included in the Charities/Not-for-Profit sub-section of the Trust and Estates listing were Miller Thomson LLP lawyers, Donald Carr Q.C., Arthur Drache, CM, Q.C., Robert Hayhoe, Susan Manwaring and Martin Rochweg while Rosanne Rocchi, John Phillips, Dragana Sanchez Glowicki, Joseph Yurkovich and William Fowlis were included as among the leading Trust and Estate lawyers in Canada.

FILING T3010s ON A TIMELY BASIS IS CRUCIAL

Arthur Drache
Toronto
416.595.8681
adrache@millerthomson.com



It is always wise to ensure that a charity's public information return is filed on a timely basis. Now, with the number of CRA audits of charities on the rise, timely filing more important.

While there are many more charity audits being done now than in prior years, few charities need worry about being selected unless there have been complaints made about them or where there have been prior alleged transgressions which have brought them to the CRA's attention. If a charity has in the past given undertakings to change some aspect of its operations or has signed a compliance agreement, it is fairly certain that at some stage an auditor will show up to check on whether the undertakings have been fulfilled.

It is true that there may also be spot audits which are based on the (bad) luck of the draw but given the number of registered charities, well over 80,000, this is not a serious concern.

Charities should be aware that the T3010s of all charities are being put on the CRA website. However, the information is inputted without anybody vetting the contents in any substantive way -they are examined seriously only when something else raises questions about the charity's operations.

The Charities Directorate takes the filing of the T3010 very seriously. In its guidelines relating to the imposition of intermediate sanctions, the Directorate has this to say:

There are two other cases where we are likely to move directly to revocation. The first is when a charity does not file its annual return. The Directorate will continue its zero-tolerance policy for non-filers - if a charity does not file its return after we have reminded it to do so, we will simply revoke its registration. In our view, filing is a fundamental obligation for all registered charities. In its annual return, a charity accounts to donors and Canadians generally for its tax-advantaged status. The return also provides the Directorate with key information needed to administer and enforce the legislation. The second are serious cases for which there is no appropriate sanction, such as engaging in non-charitable activities. However, we intend to exercise some discretion in these instances, as it is not our intention to move directly to revocation in those cases where it is possible and appropriate to work with the charity to get its operations back onside. It is our goal, in cases where the non-

compliance is less severe, to work with charities through a compliance agreement as a first measure.

By far the greatest number of revocations are for failing to file the form, an offence for which there are few if any defences.

Increasingly, we are seeing cases where a charity's registration is revoked for failing to file the T-3010 (and to be fair, there are opportunities after missing the deadline to do so without penalty). Rather than just requiring the charity to file a new application, file previously unfilled returns and pay a fee (improperly called a fine), the CRA acts as though the charity must be vetted just like a new application. The situation is exacerbated because the CRA (without a subsequent audit) will go through the whole history of the organization's operations and require justification for re-registration. We recently dealt with a case of a revocation for failure to file. The organization was called upon to justify past disbursement quota reporting based on the reviewer's belief that many of its activities were in fact political. In fact, the reviewer did not appear to be following the Charity Directorate document on what were acceptable political activities and focused on the organization's appearances before legislative committees.

Until just a few years ago, a re-registration where revocation was based on a failure to file was a routine and mundane matter. We know of one very large public foundation which had its registration revoked three times in twelve years for failure to file simply because their auditors who were doing the work on a pro bono basis kept missing deadlines and the board member who received the notices had assumed the auditor would do its job properly. The foundation decided to get new auditors, pay them, and hasn't had a problem since.

Most charities do, in fact file on time. Among the most careful are those that may feel that some part of their operations might generate questions if they had to apply for a re-registration. But all charities should make compliance a high priority so as to keep a low profile with the Directorate. Given the fact that so many smaller charities rely on volunteers and given the fact that the T-3010 is among the most difficult of all CRA forms to fill out (just look at the instruction pamphlet to see bureaucratise at its finest) the annual filing is almost a traumatic event.

When faced with the frustrations of filling in the form, keep in mind the potential consequences of a revocation.

NEW TESTS FOR DESIGNATION OF CHARITIES

Richard Fontaine
Montréal
514.871.5496
fontaine@millerthomsonpouliot.com



The Charities Directorate is now administering the proposed changes to the definitions of "charitable organization" and "public foundation", which also affects the concept of "private foundation" as defined in the *Income Tax Act* (the "Act"). The new definitions are included in Bill C-33, *Income Tax Amendments Act, 2006*.

As discussed in earlier issues, Bill C-33 replaces the "contribution test" with a new "control test". The former definitions used a "contribution test" whereby if a person, or group of persons not dealing with each other at arm's length, contributed more than 50% of the charity's capital, that charity could only be designated as a private foundation.

Under the new "control test", a charity will not be disqualified from being treated as a charitable organization or public foundation based solely on the source of its funding. Instead, the "control test" allows a person, or group of related persons, to contribute more than 50% of the charity's capital provided they do not control the charity in any way. In addition, this person, or members of the related group, may not represent more than 50% of the directors, trustees, officers and similar officials of the charity. Failure to satisfy the "control test" will result in a charity being designated as a private foundation.

The Charities Directorate is now applying the "control test" in its review of applications for registration and re-designation. Applications for re-designation can be made retroactively for taxation years that begin after 1999. However, the proposed legislation contains a limited 90-day timeframe within which a registered charity can apply for re-designation for a prior taxation year. As such, registered charities have until 90 days after Bill

C-33 receives Royal Assent to apply for retroactive re-designation. Applications received after that date will still fall under these new rules, but the re-designation will only become effective for future taxation years.

The Charities Directorate is currently developing guidelines for applying the new "control test" with respect to registered charities. The guidelines will be available in the near future on the Directorate's Web site at: www.cra.gc.ca/charities.

WHEN THE IRS STEPS INTO GOVERNANCE, CAN CRA BE FAR BEHIND?

*Hugh Kelly
Toronto
416.595.8176
hkelly@millerthomson.com*



Earlier this year, the Internal Revenue Service ("IRS") of the United States Government introduced its "Good Governance Practices Discussion Draft" (the "Governance Draft") saying:

The informal draft reflects various ideas that have been advanced by others both within and outside the exempt [approximately equivalent to the Canadian charitable] sector who have studied non-profit governance. ... Because good governance practices may promote compliance with tax law, the IRS will continue to review recent self-regulation proposals advanced by others. A consensus of good governance practices may emerge from the various proposals.

Here we have an enunciation of what a taxing authority sees as practices that charities should adopt as part of "good governance".

The introduction goes on:

While adopting a particular practice is not a requirement for exemption, an organization that adopts some or all of these practices is more likely to be successful in pursuing its exempt purposes and earning public support. Moreover, any decision by the Service to conduct a review of operations...will be influenced by whether an organization has voluntarily adopted good governance practices.

This suggests that the IRS may very well use the practices articulated as "good" in order to assess whether to continue an organization's tax exempt status.

The Governance Draft suggests that organizations review and consider:

- a clearly articulated mission statement to guide the organization's work;
- a Code of Ethics to govern directors and officers, and a "whistleblower" policy supporting confidential reporting of financial impropriety or resource misuse;
- due diligence policies supporting the duty of directors to act in good faith and in the best interests of the organization;
- conflict of interest policies that promote disclosure of personal interests that compete with the interests of the organization;
- fundraising policies that require accurate, truthful and candid disclosure of purposes and use of monies received;
- operations based on approved annual budgets, to be followed by independent audits;
- practices that limit compensation to what is reasonable for services rendered; and
- standards for document integrity, retention and destruction, with appropriate provisions for electronic handling, backup, archiving, and system reliability checks.

In the case of five of these areas, there are explicit references to IRS forms, publications or statutory provisions.

In Canada, it would not be formally acceptable (because of our constitutional division of powers) for a Federal taxing authority to move into the realm of governance. Until now, many in the not-for-profit sector have felt

that a combination of corporation statutes and the common (that is, the so-called judge made) law was the basis for determining what constitutes acceptable governance, even good governance.

Equally clearly, no one can reasonably complain against the principles set out in the Governance Draft, for they are generally quite acceptable as principles underlying good governance. There are some details, however, with some of which exception may be made, at least from a Canadian perspective. Consider these extracts and the comments from a Canadian point of view that follow:

Successful governing boards include individuals not only knowledgeable and passionate about the organization's programs, but also those with expertise in critical areas involving accounting, finance, compensation, and ethics.

While this may be a counsel of perfection, many of the organizations that we see do not have the luxury of being able to attract volunteer board members who have such a wide range of expert experience.

Organizations with very small or very large governing boards may be problematic: Small boards generally do not represent a public interest and large boards may be less attentive to oversight duties.

These criticisms may be justified in individual cases, but they are unfair generalizations.

The auditing firm should be changed periodically (e.g., every five years) to ensure a fresh look at the financial statements.

While perhaps this suggestion is well intentioned, and could possibly be appropriate in some instances, it is really difficult to see understand the justification for this practice in most cases, especially if the organization retains a competent auditor, as it most certainly should and most likely does. Even in the U.S. context, this suggestion may be an ill-disguised vote of non-confidence in auditing firms generally.

In Canada, there is renewed legislative interest in modernizing the legislation governing not-for-profit organizations, federally and in British Columbia and Ontario (Saskatchewan has already done so). With the likely adoption of good governance policies as part of these up-dating efforts, it may be speculated as to the constitutional appropriateness of Canada Revenue Agency ("CRA") embarking upon a process similar to what the IRS has done in producing the Governance Draft. But appropriate or not, one may wonder how long it will be before CRA decides to follow the lead of the IRS, and produce its own version of the Governance Draft.

CHARITABLE GAMING

Kate Lazier Campbell
Toronto
416.595.8197
kcampbell@millerthomson.com



In Canada, an independent gambling operation may be considered an offence under the *Criminal Code*. However, charities may fundraise using games and lotteries provided that they obtain a licence and follow the rules set out in the licence.

The *Criminal Code* casts a wide net around gambling. Where property is disposed of by an element of chance and consideration is paid for a chance to win, it may be an offence for the operator of the game, players and everyone else involved. Under the *Criminal Code* it is illegal to keep a place (even temporarily) where a fee is charged to the players to participate in a game or use gaming equipment. It is also an offence for a person to be found without a lawful excuse in such a place or knowingly to permit one's place to be used for the purpose of gambling. Managing, advertising selling tickets for or, buying tickets for a lottery or game of chance is also an offence. Further, it is an offence to dispose of goods by way of game of chance or mixed chance and skill in which the contestant pays money or other valuable consideration.

Charities can carry on a gaming "fun night" without a license. In such events players are given chips free of charge to gamble for the purpose of entertainment and no prizes are awarded. These events raise money by charging for some other aspect of the event such as a dinner. Charities undertaking fun nights should carefully structure the event to ensure that it does not contravene the *Criminal Code*.

A charity can charge a fee to participants to play a game if the charity obtains a gaming licence from a provincial regulator to carry on charitable gaming events. According to the Canadian Partnership for Responsible Gambling, in 2005 over 30,000 charitable gaming licenses were issued across Canada, and

charities received over \$600 million in net gaming revenue. However, it is important to note that given the nature of gambling, not all gaming fundraisers are profitable.

Provinces licence such games as bingo, raffles, sports pools, break open tickets and casino nights. Some provinces license card games including blackjack and poker. The recent popularity of poker has lead several provinces to license poker events in order to bring the existing games into the legal system, assist charities to raise funds, and ensure the integrity of game play.

While the rules for obtaining a license differ among the provinces, the Criminal Code requires that the charity itself must conduct and manage the game or lottery and that all of the proceeds from the lottery must be used for charitable or religious purposes. This means that if a donor hosts an event and provides all of the funds to a charity, the donor may still be committing a *Criminal Code* offence. This unfortunate rule could land an entrepreneurial philanthropist in trouble.

Charitable gaming also raises charitable tax receipting issues. Lottery tickets usually lack the element necessary to be considered a gift according to the CRA and therefore they are not eligible for a charitable receipt. However, poker tournaments are eligible for a receipt under the split-receipting rules according to the CRA. A receipt can be given for the amount paid to play minus: the value of dinner, the total prize amount divided by the numbers of participants, and the fee for a similar non-charitable tournament.

The law of charitable gaming is complex raising the possibility of criminal charges as well as charitable receipting issues. Miller Thomson charity and non-profit lawyers can help charities properly structure gaming fundraising events to avoid these issues.

MANITOBA TAX BREAK FOR HIRING CO-OP STUDENTS AND GRADUATES

Bryant Frydberg
Calgary
403.298.2456
bfrydberg@millerthomson.com



Manitoba first introduced the Co-operative Education Tax Credit (the "CETC") in the 2003 Provincial Budget. The purpose of this CETC is to provide training and work experience for students through co-operative education work placements. The program is also designed to retain educated workers in Manitoba and attract new workers to that province.

Basically these goals are accomplished by providing a tax credit of 10% of wages and salaries up to a maximum of \$1,000.00 per student for employers providing a work placement for co-operative education students. As well, eligible employers may be entitled to a further benefit if they hire and retain, in full time employment, students who graduated after March 6, 2006 from a recognized post secondary co-operative education program in the field of study related to the employment. The benefit for these employers totals 5% of wages and salaries paid to the graduate net of other government assistance received in support of that position, after the first consecutive 12 months of qualifying employment, and again after the second, immediately following 12 months of qualifying employment to a maximum of \$2,500.00 for each year where the employment commences within 18 months of graduation.

Both the Co-operative Education Tax Credit and the Co-operative Graduate Hiring Incentive (the "COGHI") are discussed below, including eligibility requirements of the student, the institution and the employer, as described in the *Co-operative Education Tax Credit Regulation* (Regulation 54/2004, as amended on February 9, 2007) (the "Regulation").

OVERVIEW OF CETC

There are three categories of eligibility for the CETC which must all be met to qualify for the credit. The primary eligibility component refers to the employer. "Employer" is defined in the Regulation as a taxpayer or partnership that employs a student in a qualifying work placement.

Pursuant to subsection 6(1) of the Regulation, a taxpayer who is exempt from tax under Part 1 of the *Income Tax Act* (Canada) and is deemed by Section 10.1 of the *Income Tax Act* (Manitoba) to have paid an amount on account of tax for a taxation year, equal to his or her co-operative education tax credit, may apply for a refund of that amount. Therefore, those Manitoba employers eligible for the CETC include private companies, co-operatives, Crown corporations, municipally-owned businesses, non-profit organizations, unincorporated employers, incorporations and other organizations exempt from income tax.

A work placement qualifies as a "qualifying work placement" if:

- A. it is a work placement under a co-operative education work program accredited with the Canadian Association for Co-operative Education, and under which the student's work is to be performed primarily in Manitoba; or
- B. it meets the following requirements:
 - 1. it has been developed or approved by an approved institution;
 - 2. it satisfies the conditions or restrictions imposed by the Minister of Advanced Education and Literacy;
 - 3. it is for a term of at least 10 consecutive weeks;
 - 4. the student is employed on a full-time basis throughout the term of the work placement;
 - 5. the student receives salary or wages for work performed under the work placement;
 - 6. the student is engaged in productive work and not just observing the work of others;
 - 7. the student's work is performed primarily in Manitoba for an employer who is resident in Manitoba or has a permanent establishment in Manitoba;
 - 8. the institution is satisfied that most of the student's work will provide training or work experience that is directly related to and reinforces the goals of the Co-operative Education Program;
 - 9. satisfactory completion of the work placement will earn the student a credit toward his or her degree or other certification in the Co-operative Education Program; or
 - 10. the time spent in periods of work experience is at least 20% of the time spent in academic study.

The educational institution itself must meet certain qualifications as well. The institution must be a post-secondary educational institution that offers one or more co-operative education programs, holds a work placement permit and is authorized by the Minister of Finance to issue completed work placement certificates.

The final component deals with the eligibility of the student. Basically, any student enrolled in an eligible co-operative education program offered by an approved institution will qualify. However, there is a lifetime maximum number of work placements per individual student for which the CETC benefit can be claimed. A student is limited to five (5) work placements that can qualify for the CETC (note that this maximum is per student and is not related to the employer whatsoever).

If all of the above mentioned eligibility components are satisfied and the application process is properly adhered to (for a summary of the application process for a CETC see the Cooperative Education Tax Credit and the Cooperative Graduation Hiring Incentive Procedures Manual) an employer will be entitled to a credit of a 10% of salary to a maximum of \$1,000.00 per student. For the taxpayer to receive the CETC, a taxpayer must file with his or her return for the taxation year a statement from the Minister of Finance for Manitoba certifying that the work placement qualifies as a "qualifying work placement".

OVERVIEW OF COGHI

The main function of the COGHI is to provide an incentive for employers to hire recent co-operative education graduates to work in Manitoba in a job that is related to their studies. The salient eligibility category with regard to the COGHI deals with the employer requirements, as the student and institution requirements are fairly straight forward.

To qualify, the employer must be a taxpayer or a partnership that employs a qualifying graduate for a period of qualifying employment. As discussed earlier under the overview of the CETC program, the same eligible employers including private companies, non-profit organizations, etc., are entitled to claim the COGHI benefit.

The period of employment of a "qualifying graduate" qualifies for the purposes of the Regulation if:

- A. the graduate is employed in a permanent position and not in a position for a specified term or completion of a specified task;

- B. the employment is full time (at least 35 hours per week);
- C. the work is performed primarily in Manitoba for an employer who is resident in Manitoba or has a permanent establishment in Manitoba;
- D. the work is closely related to the subject matter of the Co-operative Education Program completed by the graduate, or requires skills and knowledge acquired in that program; and
- E. the period of employment begins at the beginning of a pay period that begins:
 1. within 18 months after the graduate completed the Co-operative Education Program, if the employer has not claimed a credit under Paragraph 10.1(5) of the *Income Tax Act* (Manitoba) for a previous period of employment in relation to that graduate, or
 2. immediately after the end of the previous period of employment for which the employer has claimed a credit under Paragraph 10.1(5) of the *Income Tax Act* (Manitoba) in relation to that graduate.

Assuming that the above-mentioned eligibility categories are adhered to and the application process is followed (see the Cooperative Education Tax Credit and the Cooperative Graduate Hiring Incentive Procedure Manual for an overview of the application process) an employer may claim the credit for each number of graduates hired. There is no limit on the number of graduates that an employer may hire, but a graduate is limited to two one-year sessions of employment under the COGHI program.

If the program requirements are adhered to, the employer is entitled to a benefit that totals 5% of wages and salaries paid to the graduate net of other government assistance received in support of that position, after the first consecutive 12 months of qualifying employment and again after the second, immediately following 12 months of qualifying employment to a maximum of \$2,500.00 for each year where the employment commences within the 18 months of graduation.

As you can see, the above-mentioned credits are designed to provide Manitoba students with on the job training in conjunction with the academic portion of their co-operative education program and, secondly, to provide gainful employment for graduates who wish to remain in Manitoba for employment after their studies. Collectively, the two credits provide a tax incentive for businesses and organizations in Manitoba to hire Manitoba students and graduates in an effort to increase the quality of education of students and provide jobs for these students after graduation. Not-for-profit organizations and other entities should take note of these tax savings initiatives when looking for future employees as a way to reduce costs.

WHAT'S HAPPENING AROUND MILLER THOMSON

The July Canadian *Not-For-Profit News* included "Tromp Leaves, de March is "Acting"", "Tax Act Amendments Help Sports Non-Profits", "Appeal Process Still Fundamentally Flawed", "Relaunch of Enhanced Charity Tax Service", "Fundraising Policy Now a High Profile Issue", and "Ontario Kicks Off Non-Profit Corporate Study," all by **Arthur Drache**.

The July-August *Canadian Taxpayer* included articles "Carbon Credit Taxation" and "Irrational Charity Appeal System" both by **Arthur Drache**.

Susan Manwaring taught the Canadian Association of Gift Planners "Advanced Gift Planning Course" in Banff in August.

MILLER THOMSON LLP CHARITIES & NOT-FOR-PROFIT GROUP

Toronto/Markham

Jennifer E. Babe	416.595.8555
Rachel L. Blumenfeld	416.596.2105
Donald Carr, Q.C., O.Ont., L.H.D	416.595.8506
Kate Lazier Campbell	416.595.8197
Arthur B.C. Drache, Q.C., C.M.	416.595.8681
Mark R. Frederick	416.595.8175
Kathryn M. Frelick	416.595.2979
Robert J. Fuller, Q.C.	416.595.8514
Robert B. Hayhoe	416.595.8174
Hugh M. Kelly, Q.C.	416.595.8176
Michael Kerr	416.595.8620
Peter D. Lauwers	905.415.6470
Susan M. Manwaring	416.595.8583
Rosanne T. Rocchi	416.595.8532
Martin J. Rochweg	416.596.2116
Amanda Stacey	416.595.8169
Brenda Taylor (Corp. Services)	905.415.6739
Steven L. Wesfield	416.595.8606
Michael J. Wren	416.595.8184

Vancouver

Sandra L. Enticknap	604.643.1292
Martin N. Gifford, Q.C.	604.643.1264
Alan A. Hobkirk	604.643.1218
Eve C. Munro	604.643.1262
Donald J. Sorochan, Q.C.	604.643.1214
Monique P. Trépanier	604.643.1274

Calgary

Esmail Bharwani	403.298.2418
Gerald D. Chipeur, Q.C.	403.298.2434
William J. Fowles	403.298.2413
John D. Phillips, Q.C.	403.298.2431
Gregory P. Shannon	403.298.2482

Edmonton

Wendi P. Crowe	780.429.9764
Dragana Sanchez Glowicki	780.429.9703

London

Kristina Shaw	519.931.3511
---------------	--------------

Kitchener-Waterloo

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

Guelph

Lorelei Graham	519.780.4650
Robin-Lee A. Norris	519.780.4638

Montréal

Ronald Auclair	514.871.5477
Richard Fontaine	514.871.5496
Louise Tremblay	514.871.5476

Note:

This newsletter is provided as an information service to our clients and is a summary of current legal issues. These articles are not meant as legal opinions and readers are cautioned not to act on information provided in this newsletter without seeking specific legal advice with respect to their unique circumstances. Miller Thomson LLP uses your contact information to send you information on legal topics that may be of interest to you. It does not share your personal information outside the firm, except with subcontractors who have agreed to abide by its privacy policy and other rules.

© Miller Thomson LLP, 2007 All Rights Reserved. All Intellectual Property Rights including copyright in this publication are owned by Miller Thomson LLP. This publication may be reproduced and distributed in its entirety provided no alterations are made to the form or content. Any other form of reproduction or distribution requires the prior written consent of Miller Thomson LLP. which may be requested from the editor at charitieseditor@millerthomson.com.

www.millerthomson.com