

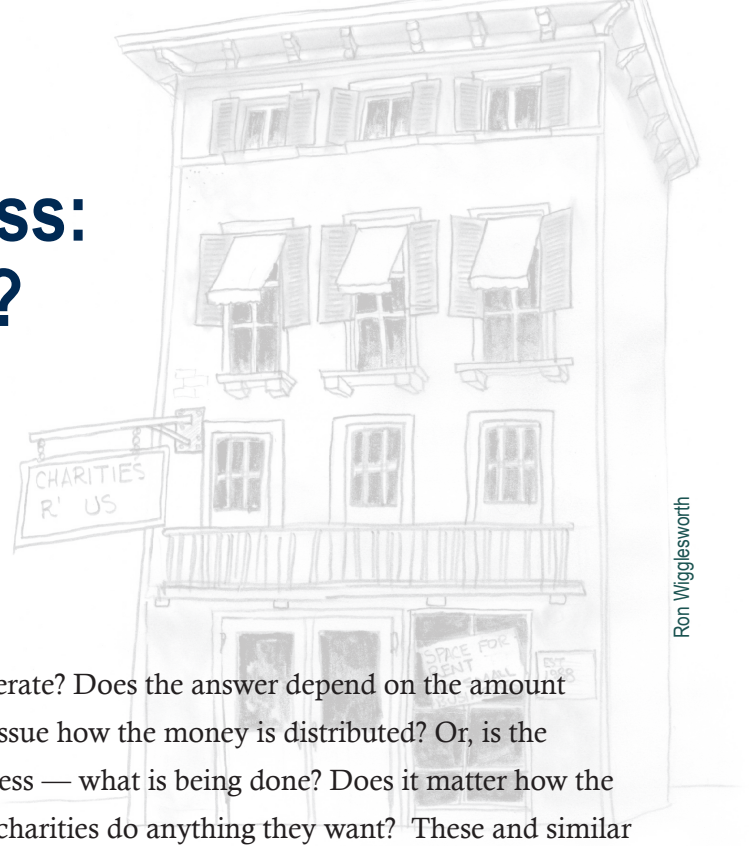
Charities in Business: What are the limits?

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What kinds of business can a charity operate? Does the answer depend on the amount of money the operation makes? Is it an issue how the money is distributed? Or, is the answer related to the nature of the business — what is being done? Does it matter how the business is run? And anyway, why can't charities do anything they want? These and similar questions increasingly preoccupy charities and their regulators. But why, in fact, are these questions at all? Explaining why these are questions and, in turn, answering them is a useful way to review the legal nature of charity and how our legal system regulates business-like operations.

Canadian charities carry out a vast range of projects, all of them intended to help or benefit people in some way. The list of what is currently being done is extremely long and varied: food banks, shelters from abuse, hospitals, libraries, symphonies, art galleries, and on and on. In fact, the Charities Directorate uses the six categories of welfare, health, education, religion (churches and others places of worship) benefits to the community and other, together with 99 sub-categories to group charities and track them.

All of these groups are authorized by the federal income tax statute to give donors receipts for gifts of money and assets made to the charity. In addition, the charity is not required



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to pay income tax. There may be other benefits as well, depending on the place where the charity operates and the subject-matter of the benefit. Exemption from property tax at the provincial level is a common example.

Underlying the notion of the value of good works done by charities, assisted by tax and other benefits, are centuries-old assumptions about how and why charities are to go about doing what they do. One reason for the difficulty associated with the questions posed at the beginning of this piece about the proper limits of being in business – for example, is the amount of money made an issue – is the growing gap between the earlier notions of why charitable works are legitimate and the current method and assumptions of charitable operations.

The Canadian law of charities traces a direct line back to the reign of the first Queen Elizabeth of England in sixteenth century England. The relationship of the state to the Church of England (the official religion, created after Elizabeth's father, Henry VIII, broke off relations with the Vatican) was strained as a political struggle developed to establish who was and should be responsible for the range of services we would describe as social welfare. Who should look after the poor? The Church or the State? Who should be responsible for opening and maintaining hospitals? The Church or the State? The period from 1550 to 1650, particularly, was marked by a struggle to resolve the jurisdictions of the secular and the sacred. Part of the way in which this trend was set was the *Statute of Elizabeth of 1601*. This early piece of legislation, coming after a horrible outbreak of bubonic plague – the Black Death – saw the State admit that it couldn't finance and manage all of the social welfare apparatus.

The *Statute of 1601* has become the reference point for the development of a method to determine what is legally charitable. First of all, charity is associated with organized effort to relieve, or provide benefit, for others: providing food for the poor, tending to the health of the sick, educating the untutored in useful learning, or furthering religious teachings and observances.

All of these traditional descriptions resonate and reflect the model of charity which came into being and which evolved — ever so slowly — from the time of Elizabeth the First to the Edwardian period early in the twentieth century. It is characterized by the notion of

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organized effort. Groups exist or come together, decide on a course of action, and then go about carrying out their purpose of relieving the poor, or one or more other charitable purposes. Moreover, the traditional notion is that to finance their operations, charities will solicit donations. By gathering together money from people who are prepared to support the purposes of the charity, benefit is delivered.

The twin features of organized philanthropy — groups getting money from people who want to support the purposes of those organizations — are recognized and confirmed by the sections of the *Income Tax Act* which provide registered charities with a tax-exempt status and the privilege of giving tax-credit receipts to people and tax-deduction receipts to corporations choosing to make donations. But where does earned money fit? The answer, both in theory and practice, is unclear.

Section 149.1(2) of the *Income Tax Act* provides that the Minister may revoke the registration of a charitable organization for any reason described in subsection 149.1(1) or where the organization carries on a business that is not a related business of that charitable organization (the rules for public and private foundations are somewhat different). Is renting out surplus space to a subtenant carrying on a business? It easily happens that a charity finds that it has unneeded space. Needs change; space becomes excess. But what if the surplus space is planned? A charity buys a building well in excess of its present and reasonable future requirements and rents out all the space it doesn't need. Has it planned to be a commercial landlord? Can the charity be said to be *carrying on a business*?

Section 248.(1) of the Act is the definition section. It provides that in the Act, the meaning of “business” includes *a profession, calling, trade, manufacture or undertaking of any kind whatever and, except for the purposes of one paragraph, an adventure or concern in the nature of trade but does not include an office or employment*. Does this definition mean that if what a charity does looks like what others do – being a commercial landlord, for instance – that charity is carrying on a business? Maybe.

The other operative requirement of the definition is that the prohibited business must be *not a related business of that charity*. Here the Act is of no help. There is no assistance with giving meaning to the phrase. The only help on this score is the single case heard in the Federal

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Court of Appeal that has considered section 149.1(2), *Alberta Institute on Mental Retardation v. Canada*, 1987.

The charity, the Alberta Institute on Mental Retardation, collected and sold used household goods to a retailer, under a contract which provided for monthly advances of \$2,000 and a fifty percent share of profits from retail sales. The Alberta Institute, in turn, transferred all its profits to its associated charity, the Alberta Association for the Mentally Handicapped. In looking at the facts the majority of two judges examined a number of factors, apparently in seeking to give meaning to the word *related*:

- The degree of relationship of the activity to the charity;
- Profit motive;
- The extent to which the business operation competes with other businesses; and
- The length of time the operation has been carried on by the charity.

Applying these criteria, the court found that a business like the one operated by the *Alberta Institute* is a related business because all the profits from that business are used to advance the charitable purpose.

But the minority of the Court noted that the mere fact that the whole of the income derived from a business operated by a charity is used for the charitable purpose of the charity is not sufficient to make that business a related business. This is so because the necessary relationship must exist between the charitable objects and the commercial activity or business itself. If it were sufficient (in order to create the necessary relationship) that the income of the business be entirely used for charitable purposes, the paragraph of the *Income Tax Act* which permits revocation of registered status for carrying on an unrelated business wouldn't ever have any effect.

The minority in *Alberta Institute* went on to note that according to the interpretation of the majority, the Minister could only cancel a registration on the ground that the charity operates a business that is not related if the income derived from that business was not used for charitable purposes. The minority further observed that if that were the case, there would be no need for the Minister to invoke the revocation section against carrying on an unrelated business because a revocation could be made on the ground that the foundation is not operated for exclusively charitable purposes.

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As the minority in *Alberta Institute* made clear there are a number of problems with this result, the so-called *destination* test. All transactions can have profit. It is a question of definition. Moreover, profitability doesn't clearly link to notions of related and unrelated. And, as the majority of the *Alberta Institute* case would have it, are profit and destination the dominant criteria? The Act recognizes a distinction between the "related" and "unrelated" business activities of charities. Like the minority in the *Alberta Institute* case, the Ontario Law Reform Commission observes in its *Report on the Law of Charities, 1996* that while the distinction is poorly defined at the margins, the core idea is clear: a business is related if it *directly advances* the goals of the charity. An unrelated business, conversely, is one that does not *directly advance* the charitable purpose.

Trying to make sense of these ideas without a clear reference point is impossible. Where to start? Earlier I noted that the current framework of charity relies on centuries-old assumptions about how and why charities are to go about doing what they do. One such key idea can be described as the core organizational features of charity: altruism and volunteering. These are in contrast to the wealth maximization purpose of the private sector and the regulatory and supervisory roles of the public sector.

For more information see the Canada Revenue Agency Policy Statement CPS-019 –What is a related business? at www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.html

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