So How Did We Get Here, Anyway?

A Short History of Charities Law

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Every day countless people across the country benefit from the work of charities. Hospitals, libraries, schools, places of worship, food banks, and theatres are but a few of the myriad of charities operating in all parts of the country. There are nearly 85,000 active charities registered under the *Income Tax Act*. Including not-for-profit organizations, there are about 161,000 incorporated entities, receiving about 9 billion dollars a year in donations from 22.2 million donors. These organizations constitute some 11% of the economically active workforce with combined revenues exceeding 120 billion dollars, greater that the mining, auto manufacturing, and oil and gas industries combined. This amounts to 7.8% of the GDP (8.6% when volunteer hours are included) so that this sector of society has a GDP that is more than our four smallest provinces combined. Measured in any variety of ways, this group is a significant presence in the country.

Canadians take pride in these organizations and have a high degree of confidence in them. A Muttart Foundation study, *Talking about Charities,* found that 77% of Canadians say they trust charities a lot or somewhat. The scope and nature of these charities and our affiliation with them says much about what it means to be Canadian.

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Yet while charities are an essential part of the way we live and provide for one another, in countless ways they are invisible, with their stories untold. Many questions can be asked. Where do charities come from? How did they get started? And when asking about how the law operates now, in what ways do their origins and history influence the laws and rules that bear on today's charities? The answers to these questions and many others mean that we need to look at the period in history near the beginning of our modern legal system. Then, by reviewing a few other events since, we can fill out the current picture of modern Canadian charity law.

Though Canada's legal system draws on the legal traditions of both France and England, Canadian charity law looks to England for much of its current meaning. Centered on the law of trusts, charity law has its roots in the England of Henry VIII and the Reformation. Being mindful of Aesop's fable about the millipede, who when asked how he could walk with so many legs, looked back and tripped, we begin our exploration of how we got here.

Henry VIII I Am, I Am

Few if any periods of English history are as chaotic and momentous as the one which sees Henry Tudor – Henry VIII – become King of England in 1509. And this is saying a lot given the vast storehouse of events that stretch from well before William the Conqueror to the long reign of Elizabeth II. In the space of about 100 years every aspect of life in English society changed dramatically.

Across central and north-western Europe during the 16th century, there was a great religious movement seeking reform of the doctrines and practices of the Church of Rome and ending with the start of various Reformed or Protestant churches. This development took many forms in different places. And nowhere but England was the struggle to advance the desired reforms bound up so intimately with the formal ordering of society: the state and its government.[1] And Henry VIII was in the middle of it.

What makes the English Reformation so important for the current law of charity is related to part of the new role Henry VIII selected for the state over which he presided. During his struggle for power with Rome, the King moved to regulate what was seen as "good", the same essence of human endeavour that is the core of charities law.

Since the dawn of western civilization in the Greek city-states, persons with wealth have given with the idea of benefiting society. In mediaeval England the doctrines of the universal church encouraged the pursuit of "faith, hope, and charity", and "charity" in the sense of caring for the condition of one's neighbour in society found natural expression in donation for public purposes. In England, prior to the sixteenth century Reformation, gifting by the faithful was essentially to the Church but also to the guilds. Both organizations gave care and succour to the needy in society.[2]

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At no time before or since has the machinery of the English or Canadian state intervened to such an extent to regulate conduct previously left to the moral code of the parties and the church.[3] Legal changes under Henry VIII saw large numbers of monasteries closed and their property transferred to the state. The King became the head of a new church, the Church of England, and Defender of the Faith. Popular views about what was proper for charity shifted dramatically.[4] Before Henry's actions, the Church had both moral and legal responsibility over charity. After Henry's revolution in social organization "… direct involvement by the secular well-to-do in the carrying out of charitable acts began in earnest with the disappearance of the mediaeval church. The latter half of the sixteenth century saw the beginning of that involvement."[5]

Before these momentous changes in social practice, the recipient was bound only by his or her conscience to obey the donor's wishes; afterwards the courts played the key role: the preoccupation of what must be done moved from the moral to the legal realm, where its development has been evolving ever since.

A gift is an absolute transfer of property. "Here the car is yours. You can do anything you want with it; drive it, store it, sell it or give it away yourself." The person making the gift has no control over what happens once the gift is made. In pre-Reformation times much conflict arose when gifts of money given to priests and the church to pay for prayers for the souls of the departed instead found its way to the support of church officials and the building of overly splendid church buildings. The remaining relatives, while much aggrieved and increasingly vocal, had little remedy, particularly galling in the common situation of gifts made on contemplation of immediate death to ensure a proper transmission of the soul to heaven.

From this situation the *use* was developed and the concept of the *use* is the basis of the modern trust. A use was a gift of property to someone for the use and benefit of another, and, importantly, this direction could be enforced by the King's Court of Equity. Rich families turned to the use to accomplish two broad goals: to avoid Crown duties – an early example of tax planning – and to see to it that religious intentions were fulfilled. The first goal – gifts for the use of and benefit of named beneficiaries developed into the modern notion of private trusts. The second goal evolved into the current formulation of the charitable trust; the major differences between them being duration and purpose. A charitable trust is a public trust, or, more properly, a trust with public purposes. And because the effects of a public trust can continue so long as the object remains to be fulfilled – poverty, for example, charitable trusts can last forever. Private trusts, on the other hand, are subject to rules that limited their existence. But a scheme that is really to

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achieve a purpose and not to directly benefit specific people (who out of enlightened self-interest can be relied upon to see that things are done correctly) and which can last forever is one potentially subject to as much abuse as the former situation of gifts that bind only conscience. It was in an effort to remedy this potential for abuse that the courts developed their jurisdiction over charitable uses and trusts. In so doing, the role of the church or ecclesiastical courts was replaced by the courts of common law.

The *Statute of Uses* of 1601 is commonly seen as the beginning of modern charity law. Its famous Preamble sets out a classification of the kinds of uses that would be considered charitable. The statute is one of the first times the phrase "charitable use" is seen in historical records. In fact, the statute was an administrative adjustment to how charitable uses were to be managed and enforced based on what the courts had been doing. And from the use developed the law of trusts.

In the slightly more than 400 years since, the trust portion of charitable law has developed an elaborate set of rules to address all aspects of gifts given for recognized public purposes. Its most notable feature is that if a trust is for a non-charitable purpose, that trust cannot be enforced and therefore fails to be legal. The famous 1891 House of Lords decision, Pemsel's case (*Special Commissioners of Income Tax v. Pemsel*) established that the only charitable purposes that the law recognizes are trusts that (1) advance religion, (2) relieve poverty, (3) advance education or (4) are purposes that are for the public benefit and which the courts have approved as charitable, health promotion being an example.

Administrative Schemes and the Tax Man

In parallel to the courts working out the complex rules about what is a charitable trust, two other developments were under way in the mid-18th century. The first was addressed in many cases (and later in statutes) where the courts were called on to answer the question: what happens when charitable purposes are fulfilled or change? The second was the development of laws to regulate the tax treatment of charitable trusts and organizations that undertake charitable purposes and the tax benefit to be afforded to people and companies that donate to these charities.

After the early rules were developed about what is charitable, the courts, in dealing with the interpretation of wills, were called on to answer the question: what happens when the charitable purpose that the person making the will wanted to benefit has disappeared or changed? "I give all of my estate to relieve the poor people of the village of Smith Junction." While this may have been a perfectly proper charitable bequest when the will was made, what happens if Smith Junction doesn't exist when the person dies and there are no poor people in that village to benefit?

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The courts took on the role of answering this question by assuming they had the authority to do so because there are no beneficiaries to be self-interested. This inherent jurisdiction is given effect in a doctrine the courts have developed (called *cy-pres*) where the courts will assess the donor's intention from a variety of sources – the will and other evidence – and substitute a charitable outcome in keeping with what is presumed to be intended. So, continuing with the example, if Smith Falls, a nearby town exists and was a place the donor knew well, the poor of Smith Falls would be substituted for the poor of Smith Junction.

In addition to these questions, once a charitable purpose has been given effect by trustees or directors, the courts have been asked: what happens if there is more money than is needed; what happens if trustees are neglecting their duties or have taken trust property; or what happens where a condition in a trust become illegal? This happened some years ago in Ontario where a charity set up many years before had what, in modern legal terms, was a racially discriminating condition disqualifying some from receiving benefit under the trust. The courts responded, in a similar manner of finding inherent jurisdiction to solve these problems, by creating administrative schemes to answer how these problems can be fixed.

The last person to sit at the charitable table has been the tax collector; seated for only about 100 years. The general trend of the courts in dealing with estates and question of charity has been to look for ways to make sure that charitable purposes are found to exist and carried out as expeditiously as possible. However, the fiscal authorities, relying on the nature of taxing statutes, bring a quite different perspective: what is the tax cost of giving a benefit to charities and donors? And instead of looking to the law and history of England for examples, the tax perspective is uniquely Canadian.

A 1917 wartime regulation first imposed income tax in this country. Since then a network of not always consistent rules has developed: at the federal level for income taxation of individuals, corporations, and for goods and services; at the provincial level for similar tax issues; and at the provincial and municipal level for property taxes when charities own land.

For most Canadians, the legal regime that comes to mind when charities are mentioned is the *Income Tax Act* and the donation receipt. This is only natural as the tax treatment of charitable giving in Canada is in the billions of dollars. And so, where once the public policy concerns of what is charitable and how should charities be administered were questions left to the courts, these questions are now being asked in the context of a regime that provides a public financial benefit in addition to ensuring that charitable intentions are clear and enforceable. Once a matter between an individual and their God, and then a matter of conscience given effect

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by the courts, charity in Canada is now a partnership of private and public interests struggling to do good, together.

The Current Scene – Exclusively and Legally Charitable Purposes and Public Benefit

All Canadian charities that seek to issue receipts register under the *Income tax Act (ITA).* Registration requires the applicant to file an application with the Canada Revenue Agency (CRA), and send in the required documentation. Among others things, applicants must satisfy the CRA that its purposes and activities are legally charitable. The *ITA* doesn't define "charitable"; instead charity has the sense given to it by the common law. That meaning has two fundamental requirements:

- all purposes must be exclusively and legally charitable; and
- the benefit must be for the public or a sufficient segment of the public ("the public benefit test").

In Canada an organization is "legally" charitable if its purposes fall within, or a clear analogy can be drawn to, purposes previously recognized as legally charitable. There are four broad categories of charitable purposes: the relief of poverty, the advancement of education, the advancement of religion, and certain other purposes beneficial to the community in a way the law regards as charitable.

Unless a purpose falls within (or a clear analogy can be drawn to) a previously recognized purpose, an applicant can't be registered as a charity under the *ITA.* Purposes must not only be legally charitable, they must also be exclusively charitable. The presence of one or more non-charitable objects or purposes[6] among several charitable ones can be fatal to an application. The exception is where a non-charitable object is merely ancillary and incidental to an otherwise charitable object and essentially a means to fulfill that purpose.[7]

In addition, an organization must clearly restrict its operations to charitable activity; it cannot be allowed to follow just any activity. And the activities and programs the applicant does undertake must also be charitable. In reviewing an organization's activities, the CRA examiner looks to see whether a particular activity advances or furthers one of the stated charitable purposes. If it does (and the activity is not political – in which case certain limits would apply) then the purpose or object is considered charitable and falling within the scope of section 149.1 of the Act. This part of the *Income Tax Act* is the core section, providing for the registration and tax treatment of charities.

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complicated, confusing, unclear, and contradictory. Charities law is, as M.R. Chesterman calls it in *Charities, Trusts and Social Welfare* (1979), a peculiar blend of trusts law, tax law and administrative law. At the centre of this mélange are stories of countless decisions by untold numbers of people trying to deal with one of the most difficult of human questions: what is good?

In its most fundamental and general sense charity is about doing good for others. The law reflects this essence but casts it in its own terms. It is in the legal details of that formulation where our current law about charities finds its home. Indeed, charities law is that odd blend of trust law, tax law, administrative law (and companies' law), together trying to regulate how good is done. And in Canada we have the peculiarity of confederation – the provinces have legal authority over some aspects of charities and the federal government over others. No wonder history has given us complication, confusion, lack of focus and contradiction. It's a wonder the law works at all!

Notes

1 The history of this period is one of intense scholarship. New ways of examining the Tudor state and its transformation of society continue to be developed. See: Alford, S., "Politics and Political History in the Tudor Century", 42:2 (Jun., 1999) The Historical Journal 535.

2 Waters, D. W. M. Law of Trusts in Canada, 3rd ed. (Toronto: Thomson Carswell, 2005) at p. 623.

3 For a fascinating look at courts and politics and the Court of Chancery which saw significant development during Tudor times see: Hackney, J, "The Politics of the Chancery", (1981) Current Legal Problems 114.

4 For a wonderfully evocative fictional account of this period by a lawyer and historian, see the Matthew Shardlake Mystery series by C.J. Sansom., Dissolution, Dark Fire, Sovereign and Revelation, Penguin Books.

5 Waters at p. 623. For extensive details of this period and its many implications for law, politics and charity see: Jones, Gareth H., *History of the Law of Charity*, 1532-1827 (Cambridge,: University Press, 1969).

6 The article uses "purposes" in contrast to "objects" in recognition of the importance and implications of Professors Waters observation. As Snell points out, "[t]he question, strictly speaking, is not whether a 'charity' exists, but whether the trusts on which property is held are trusts for charitable purposes." To which might be added, "or whether the objects of a corporation are charitable". Waters, p.625.

7 Waters, p. 625.