Choice of Private Foundation Structure – Corporate or Trust?

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PRESENTED BY:
RICHARD NIEDERMAYER
CBA – NS CHARITIES AND NOT-FOR-PROFIT SECTION

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Introduction

- More clients exploring ways to create an ongoing charitable legacy.
- Both during lifetime and upon death.
- Pros and cons to various options for private charitable foundation structuring.

Topics

- Statutory framework
- Why create a private foundation?
- Using a corporation
- NFPA specifics
- Using a trust
- Corporation v. trust

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Statutory Framework

- *Income Tax Act* (Canada) ("ITA") distinguishes "charitable organizations" and "charitable foundations".
- Charitable foundation "means a corporation or trust that is constituted and operated exclusively for charitable purposes, no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof, and that is not a charitable organization".

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Statutory Framework (Continued)

- Charitable organization "means an organization, whether or not incorporated, (a) all the resources of which are devoted to charitable activities carried on by the organization itself, (b) no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settler thereof, (c) more than 50% of the directors, trustees, officers or like officials of which deal with each other and with each of the other directors, trustees, officers or officials at arm's length…"

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Statutory Framework (Continued)

- The foundation must have purposes, objects or activities that fit within the listed charitable parameters, the members of the entity (whether they be trustees, directors or members) cannot share in the entity's profit or financial resources.
- Focus here is on private foundation as opposed to public foundations.
- ITA defines "private foundation" to mean a charitable foundation that is not a public foundation (a very helpful definition).

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Statutory Framework (Continued)

- "Public foundation" means more than 50% of the directors, trustees, officers or like officials deal at arm's length with each other and with the main contributor and which is not, if it were a corporation, controlled directly or indirectly by a person who contributed more than 50% of the capital of the foundation.
- To be charitable must have objects that are charitable, and the power to accept gifts, donations and bequests and to disburse those amounts to other registered charities or "qualified donees" within the meaning of the ITA.

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Statutory Framework (Continued)

- Private foundations cannot carry on a business activity of any kind (even if it is a “related business”) unlike a charitable organization or a public foundation, and private foundations have restrictions on ownership of shares of corporations related to the charity or its directors or members.
- Note: “Foundations” are not a legal entity in Canada - they must be trust or body corporate which satisfies the definition of “foundation” in the ITA.
- That said, you can call a trust a “foundation” easily.

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Statutory Framework (Continued)

- Registry of Joint Stocks will not permit a company or a society to use the term “foundation” in its name unless it provides proof it has at least $25,000 of net assets.
- Not same problem with a Federal corporation.

Why Use A Private Foundation?

- Flexible and increasingly popular tool for families with significant wealth to establish a private charitable foundation.
- Foundation is controlled by the family.
- Family members can make lump sum charitable donations from time to time as they wish.
- Once foundation is registered with CRA family members receive charitable donation receipts for their donation which could be used to offset taxes otherwise payable (up to 75% of taxable income in a particular year).

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Why Use A Private Foundation? (Continued)

- Don’t have to decide at time of gift what ultimate charity will receive the donations – can be done at a later date.
- Allows capital endowment fund to build up to accomplish a more significant charitable gift program in the future.
- Relatively easy to establish (usually as a trust) and relatively straightforward CRA registration because of broad objectives (i.e. payments to other registered charities or qualified donees).

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Why Use A Private Foundation? (Continued)

- Requires a disbursement quota of 3.5% of value of assets per year at minimum.
- Can provide a training ground for younger family members in philanthropy and investing.
- Can be an important connection with other family governing structures such as a family council and family board of directors.
- Can act as a tool to deflect donation requests to an impartial board.

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Why Use A Private Foundation? (Continued)

- However, because of annual filing requirements the financial statements of the foundation are a matter of public record on the CRA website and hence there is a certain degree of lost privacy.
- Also must consider the (relatively low) administrative cost of operating the foundation.

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Using A Corporation For A Private Foundation

- Could be a body corporate under various statutes:
  - Company limited by guarantee under the Nova Scotia *Companies Act*.
  - Company limited by shares under the Nova Scotia *Companies Act*.
  - Corporation under the *Canada Not-For-Profit Corporations Act*.

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Using A Corporation For A Private Foundation (Continued)

- Given the restrictions on charitable purpose and lack of member/shareholder benefit that are required, use of a company limited by shares is uncommon.
- Convention is for Nova Scotia companies to be a company limited by guarantee.
- For a company limited by guarantee, the members are personally exposed to the extent of the amount guaranteed (which can be nominal) - see Section 11 of the *Companies Act*.

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Using A Corporation For A Private Foundation (Continued)

- A holdover from the U.K. legislation on which the *Companies Act* was originally based.
- In either case there needs to be a blocker clause added to the constating documents that bars the members from deriving any financial benefit from their membership.
- An example of such a provision is as follows:

Using A Corporation For A Private Foundation (Continued)

the Company shall not enter into any transaction, carry on any activity, or engage in any business for profit, and any income received by the company shall be applied exclusively to the purposes and objects of the Company, and no part thereof shall ever enure to the benefit of any member or individual, and PROVIDED further that, in the event of liquidation, dissolution or winding up of the Company, the surplus assets, if any, after all liabilities of the Company have been paid, shall not be distributed to any member of the Company, but shall be transferred to one or more registered charities or to one or more entities having non-profit objects that include objects which are the same as or substantially similar to the objects of the Company.

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Using A Corporation For A Private Foundation (Continued)

- Otherwise with respect to the liability of the members, guarantee companies and companies limited by shares operate exactly the same in terms of their governance – all the same other provisions of the *Companies Act* apply.

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New Federal NFPA

- On October 17, 2011 the *Canada Not-For-Profit Corporations Act* ("NFPA") came into force replacing the *Canada Corporations Act* ("CCA") for federal corporations without share capital.
- At the time, over 19,000 corporations were under the CCA.
- NFPA modeled on the *Canada Business Corporations Act* – much more modern than the CCA which came into force in 1917.
- All corporations incorporated under the CCA will need to "continue" under the NFPA by **October 17, 2014**.

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Key Features of NFPA

- Distinguishes between soliciting and non-soliciting corporations
- Soliciting – receives more than $10,000 in income from public sources during a financial year (public sources include gifts or donations from a non-member)
- Non-Soliciting – receives less than $10,000 from public funds in each of its three previous financial years
- Important because more onerous requirements imposed on soliciting corporations (minimum three directors, audit requirements, filing annual statements etc.)

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Key Features of NFPA (Continued)

- Non-soliciting corporations need only one director
- Soliciting corporations need at least three, two of whom cannot be officers or employees of the corporation
- Cannot have ex-officio directors under the NFPA
- Standard corporate rules of governance for directors will apply
- Includes due diligence defences for some negligence claims
- Non-soliciting corporation may have a unanimous members agreement restricting the powers of the directors to manage the activities and affairs of the corporation

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Key Features of NFPA (Continued)

- Can now have more than one class of members
- If more than one, articles must define how each class differs in the responsibilities associated with them
- Non-voting members of a class can still vote on the matters directly affecting their class
- Fundamental changes to articles or by-laws require approval of a special resolution (66 2/3rds consent)
- Members generally have broader rights under NFPA than CCA

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Key Features of NFPA (Continued)

- Directors enact by-laws to regulate business affairs of corporation
- Must be then confirmed by the members
- A “by-law builder” exists on the Industry Canada website
- Directors must provide financial disclosure to members at annual meeting
- Generally must appoint public accountant as auditor unless members vote unanimously not to appoint an auditor
- Exemption only available to soliciting corporations with annual revenues less than $50,000 or non-soliciting corporations with annual revenues less than $1,000,000

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Key Features of NFPA (Continued)

- Incorporation under NFPA similar to a regular corporation
- Standard forms prepared by Industry Canada
- **Caution** – Incorporation under NFPA does not guarantee a corporation will become a registered charity with CRA under the ITA

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Continuance under NFPA

- Note: Existing CCA corporations are not automatically transferred under the NFPA
- Must continue by October 17, 2014
- If not done by then the CCA company will be deemed inactive and dissolved (subject to a revival process)
- Continuing corporation needs to enact new by-laws, typically in standard form
- Only two by-laws are required under NFPA – conditions of membership and appropriate notice of time and place for meeting of members entitled to vote at such meeting
- A number of provisions NFPA for default by-laws will apply if not overridden by corporation

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Foundations Formed As Trusts

- Trust is a very flexible charitable planning tool.
- Established as either an *inter vivos* trust or a testamentary trust.
- If testamentary, terms are set out in the will of the deceased testator/settler and powers of trustees and objects of the trust are set out in the will.
- If *inter vivos*, the settlor contributes property to settle the trust and terms are outlined in a trust deed/trust agreement/trust indenture.
- Need similar object clauses to ensure trust will be registered with CRA.

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Foundations Formed As Trusts (Continued)

- Otherwise looks like a regular trust in terms of trustee provisions, duties and powers.
- *Inter vivos trust* is registered at time of settlement.
- Testamentary trust is registered by the estate after death.
- Note: can claim a tax credit for portion of estate transferred to a testamentary trust that is registered after death against terminal return and one year prior (at 100% taxable income offset) or in estate itself (at 75% income offset).

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Foundations Formed As Trusts (Continued)

- Not to be confused with a charitable remainder trust where may obtain a credit at time of establishment based on present value of a future gift where capital held for life income beneficiary with remainder to charity if no (or limited) power to encroach on capital to life beneficiary.
- Budget 2014 announced improvements to charitable donation use in that now can carry forward into the estate unused credits from terminal year and year prior (wasted before) – applicable for 2016 and after.
- Should enhance charitable giving.

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Foundations Formed As Trusts (Continued)

- BUT still no change to treatment of non-discretionary distributions from trusts (particularly alter ego and joint partner trusts) as not being "gifts" under the ITA and not subject to any credit – careful drafting is required (a whole other topic!).

Corporation v. Trust

- Pros and cons to each form of foundation.
- Corporation is usually more expensive to set up and has ongoing annual registration and filing requirements with the Registry of Joint Stock Companies or Corporations Canada.
- Trust on the other hand is usually less expensive to establish and has no annual maintenance costs apart from financial statement preparation and filing with CRA (which the corporation must do also).
- Trust can be a very flexible document – more so than a corporation.

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Corporation v. Trust (Continued)

- Corporation may be a better vehicle for very large foundations which employ people and conduct more robust investing activities as it is a legal entity unlike the trust.
- At the end of the day the ultimate choice of entity depends on the client's personal situation.

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Questions

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Thank You!

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Contact Information

Richard Niedermayer, TEP
Partner
Stewart McKelvey
Purdy’s Wharf, Tower I
1959 Upper Water Street, Suite 900
Halifax, Nova Scotia B3J 3N2
RNiedermayer@stewartmckelvey.com
Tel: 902-420-3339
www.stewartmckelvey.com

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