



business meeting

## RUNNING A NOT-FOR-PROFIT ORGANIZATION

Perhaps the most striking aspect of Canada's not-for-profit (NFP) sector is the sheer number and variety of organizations which fall under the NFP umbrella. Those organizations can range from a local soccer league or theatre group run solely by volunteers to organizations in the health care or education sectors which employ thousands of Canadians.

However, all Canadian not-for-profit (NFP) corporations, whether large or small, operating on a shoestring or multi-million dollar budget, are governed by much the same set of legal rules and government administrative policies, and those are outlined below.



Wolters Kluwer

## *Distinguishing not-for-profit organizations from charities*

Although they are often referred to interchangeably in everyday usage, NFP organizations are not at all the same as charities, and vice-versa. In fact, for purposes of our tax and regulatory systems, if an entity meets the definition of a charity, it cannot be considered an NFP organization. An organization can be one or the other, but not both.

Confusion between the two types of entities is understandable, as there are similarities. For instance, both operate on a non-profit basis and are generally exempt from income tax, and neither can use its income to personally benefit members. However, an NFP organization does not have to obtain registration as such with the Canada Revenue Agency (CRA) and, more importantly, it cannot provide a charitable donations tax receipt for any donations it receives. As well, a charitable organization is required to disburse a certain amount each year to further its charitable ends, while no such requirement applies to NFP organizations.

Perhaps the easiest way to distinguish between the two types of organizations is through an examination of the types of activities in which they can engage. The range of activities available to NFP organizations is virtually limitless – they can involve themselves in efforts which promote or carry out any social welfare, civic improvement, pleasure, sport, or recreational endeavours. The only real restrictions on the activities of NFP organizations are that they cannot carry out their activities, of any kind, on a for-profit basis and they cannot operate exclusively for charitable purposes.

By contrast, the limitations on permitted activities of charities are much more stringent. While the list of possible charitable causes is almost limitless, such causes must, in order for the organization to qualify as a registered charity, fall under one or more of four categories permitted by the CRA. Those four categories, with examples, are as follows:

- relief of poverty (food banks, soup kitchens, low-cost housing units).
- advancement of education (colleges, universities, research institutes).
- advancement of religion (places of worship, missionary organizations).
- purposes beneficial to the community (animal shelters, libraries, volunteer fire departments).

Conversely, the CRA provides the following examples of organizations which would qualify as NFP organizations, but not as charities:

- social, recreational, or hobby groups (bridge clubs, curling clubs, golf clubs)
- certain amateur sports organizations (hockey associations, baseball leagues, soccer leagues)
- some festival organizations (parades, seasonal celebrations).

It's easy to see that some overlap in qualifying activities could occur, especially where the organization is formed and operates for the benefit of the wider community. However, generally speaking, while both types of organizations can do work to benefit the community, the rules governing the permitted activities of registered charities are clearly more restrictive.

## *Starting an NFP organization and deciding whether to incorporate*

One of the first questions which must be considered by a new NFP group is whether it makes sense to incorporate. Incorporation brings with it a number of benefits — the downside or “cost” of those benefits is the fact that the affairs of the corporation will have to be conducted in a more structured and formal manner, in compliance with a number of legal and administrative obligations and requirements.

Most of the benefits to be obtained from incorporation arise from the fact that an NFP corporation, like its for-profit counterparts, has its own legal existence, separate from that of its members. That separate legal existence has a number of beneficial practical consequences. First, individuals who create a not-for-profit organization generally hope and expect that it will flourish and continue its work over a number of years or even decades. Inevitably, those individuals will be replaced, over the years, by a new generation of members and supporters. If the NFP organization is incorporated at the outset, its existence will continue even as the membership and leadership of the organization changes over time. Second, where any contracts or other legal obligations are entered into by the NFP corporation, then only the corporation, and not the members, can be held liable under those contracts. And, in the unfortunately event that legal action



# TAXES

is brought against the organization, for whatever reason, it will be the NFP corporation and not its members which will face potential liability for damages. In the same way, the NFP corporation can own property in its own name, so that property acquired by that corporation does not have to be held personally by any of the members of the organization. Finally, government or private entities which might be approached to provide funding or sponsorship for the organization will likely require that it be incorporated in order to receive financial support, so that such support can be provided directly to the NFP corporation, not funneled through the individuals who operate it.

### *Creating a not-for-profit corporation*

Once the decision is made to incorporate the new NFP organization, there are two options for taking the steps needed to complete the incorporation. It's possible to carry out the process online on the Corporations Canada Online Filing Center at [www.ic.gc.ca/app/scr/cc/CorporationsCanada/hm.html?locale=en\\_CA](http://www.ic.gc.ca/app/scr/cc/CorporationsCanada/hm.html?locale=en_CA), or the incorporation can be effected by filing the necessary documents in hard copy, by email attachment, fax, or mail. The method used does not affect the kind of information and documentary requirements for incorporation. Online incorporation is a quicker process, and slightly less expensive. The filing fee for an online incorporation is \$200, as compared

to the fee of \$250 for an incorporation effected by fax, mail, or e-mail. No matter what the method, in order to incorporate an NFP company, those applying must do each of the following:

- **Provide contact information and the corporate name** — the incorporators are free to choose the name of the corporation themselves, but must provide Corporations Canada with the results of a NUANS search. That search (which can be carried out online at [www.nuans.com/nuansinfo\\_en/home-accueil\\_en.cgi](http://www.nuans.com/nuansinfo_en/home-accueil_en.cgi)) will compare the proposed name of the new NFP corporation with the names of existing Canadian corporations to ensure that a name is not already taken or that the proposed name is not too similar to one already in use.
- **Draft articles of incorporation** — Corporations Canada provides a form which can be used to draft the Articles of Incorporation, and that form can be found at [www.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4001-e.pdf/\\$file/FRM-4001-e.pdf](http://www.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4001-e.pdf/$file/FRM-4001-e.pdf). The form contains spaces for the incorporators to provide a statement of the purposes of the corporation as well as any restrictions on the activities of the corporation, identify the minimum and maximum number of directors that the corporation will have and the classes of members,

and finally, to specify what will happen to any property owned by the corporation when and if it is dissolved.

- **File a Form 4002** — it is on this form that the name and address of the NFP corporation are provided, together with a list of the names and addresses of the directors of the corporation. Form 4002 can be found on the Corporations Canada website at [www.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4002-e.pdf/\\$file/FRM-4002-e.pdf](http://www.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4002-e.pdf/$file/FRM-4002-e.pdf).
- **Pay the filing fee for incorporation.**

Once the incorporation of the organization is completed, there are a number of further organizational steps which must be taken. The first of those is the holding of a meeting of the directors of the new NFP company. At that organizational meeting, the directors must deal with the details of the structure of the new organization, including taking the following steps:

- making by-laws;
- adopting forms for corporate records;
- authorizing the issuance of debt obligations;
- appointing officers;
- appointing an interim public accountant to hold office until the first meeting of members;
- issuing memberships; and
- making banking arrangements.

The most important task to be accomplished at the first meeting of the directors is the formulation and adoption of a set of corporate by-laws, which are the rules by which the operations and governance of the corporation will be carried out on a day-to-day basis. By-laws of the company will typically cover the following:

- the date of a corporation's financial year-end;
- the process and special requirements for banking arrangements;
- the qualification requirements for memberships;
- the process for appointing officers, as well as the rules regarding their qualifications and duties;
- the procedures for calling and conducting directors' and members' meetings;
- the minimum number of directors and members required to establish quorum at meetings; and
- the process for amending by-laws.

Some of the decisions taken by the directors at their first meeting must be confirmed by the members of the organization. Consequently, once the first organizational meeting of the directors has been held and the by-laws adopted, it's necessary to call a full meeting of the members. While that meeting can take place any time up to 18 months after incorporation, the usual practice is to hold the first members' meeting immediately after the first meeting of the directors. The first members' meeting has a number of important purposes. First, the members must adopt (or modify, or reject) the by-laws which were passed by the directors at their first meeting. While the directors have the right and the obligation to formulate and put forward those by-laws, they must be confirmed by the membership of the organization as a whole. Similarly, while the directors can appoint an accountant for the corporation, their choice must be approved by the membership at the first meeting. The first members' meeting will also include the election of the organization's Board of Directors. Although the names of the incorporating directors are submitted in the application for incorporation, each of those individuals must be approved as a director by the full membership. Consequently, an election of directors is held at the first full meeting of the membership.

### *Obtaining provincial/territorial registration as a non-profit corporation*

Once the NFP corporation is incorporated through Corporations Canada, it has a formal legal existence, but further steps may be required to allow it to carry on its planned activities within a particular province or territory. Many Canadian provinces and territories require such NFP corporations to register with the provincial or territorial authorities and may, in addition, require annual filings and levy a filing or registration fee.

As each province or territory sets its own rules in this respect, there are no general rules which will apply across Canada. However, information on the requirements imposed by a particular province or territory can be obtained from its corporation administration authorities. A listing of the contact information for those authorities in each province and territory can be found at [www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01134.html#](http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01134.html#).



### *Obtaining a business number*

A company's business number is the identifier used by the company in virtually all of its dealings with the federal government, whether for goods and services/harmonized sales tax, payroll reporting and deductions or import/export duties and taxes. While the new NFP corporation will need a business number, obtaining that number is one step that the organizers of the company don't have to worry about. As part of the incorporation process, Corporations Canada will register the new NFP corporation with the CRA and then will inform the new company of its Business Number and the program accounts (payroll, harmonized sales tax etc.) for which it is registered.

### *Maintaining an NFP corporation's tax-exempt status*

An organization which qualifies as an NFP organization, whether incorporated or not, is by definition exempt from income tax if it meets all the requirements imposed by the CRA. In order to be an NFP organization exempt from income tax, the organization must be organized and operated solely for one or more of the four purposes outlined above.

Regardless of the social, recreational, or other purpose for which an NPO is created or incorporated, the not-for-profit requirement is paramount. Specifically, to be considered an NPO, none of the income of the organization can be "payable to or available for the personal benefit of any proprietor, member, or shareholder".

The rules prohibiting income of an NPO from being made available to or paid to a member of the organization don't require that everyone doing

work for or on behalf of the organization do so on a purely volunteer basis. The organization can, without jeopardizing its tax-exempt NFP status, pay salaries, wages, fees, or honorariums to members for services rendered to the organization, as long as the amounts paid are reasonable for the services rendered. Essentially, any such amounts paid to a member of the organization must be no more than would be paid to someone who performs the same services for the organization but is not a member. In addition, where members of an organization incur costs for activities which further the aims and goals of that organization (e.g., attendance at a conference on behalf of the organization), it is legitimate for the organization to reimburse them for those costs.

### *Reporting and filing obligations of NFP organizations*

An NFP corporation may be subject to annual reporting requirements in one or more areas, depending on the size of the organization and the kinds of activities it engages in. First, like all corporations, an NFP corporation will have to fulfill its annual filing requirements with Corporations Canada in order to maintain its status as an NFP corporation. They will also have to file an annual tax return with the CRA, although the type of return required will depend upon the kinds of activities engaged in by the NFP corporation. Finally, some larger NFP organizations, whether incorporated or not, may be required to file an annual information return with the CRA.

### **Filings required by Corporations Canada**

All corporations, whether NFP or not, owe their existence to the fact that government authorities, in the form of corporate registry offices, have certified that they meet existing legal and regulatory requirements. Generally speaking, corporations are required to confirm their continued compliance with those requirements through annual filings with the appropriate federal or provincial government. Those who do not can be stricken from the corporate registry, meaning, that they effectively no longer exist.

For an NFP corporation, Corporations Canada imposes the following requirements:

- file an annual return;
- file any change of registered office address;

- report changes regarding directors;
- file financial statements and public accountant's report;
- file any change in articles; and
- file any change in by-laws.

While the list of required filings can look forbidding, for many smaller NFP corporations the annual return will be the only filing actually required every year. Many of the other filing obligations are triggered only where there is a significant change in the affairs of the corporation — a change in the location of the registered office, a change in directors, or a change in the articles of incorporation or the by-laws. As well, the requirement to file financial statements applies only to what are termed “soliciting” NFP corporations, defined by Corporations Canada as those that receive public donations and/or government grants in excess of \$10,000 in a single financial year.

The annual return which must be filed every year by every NFP corporation, regardless of size, is due within 60 days after the corporation's anniversary date. The return, which can be found at [http://corporationscanada.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4022-e.pdf/\\$file/FRM-4022-e.pdf](http://corporationscanada.ic.gc.ca/eic/site/cd-dgc.nsf/vwapj/FRM-4022-e.pdf/$file/FRM-4022-e.pdf), is only one page in length. The person filing the return, and signing it on behalf of the corporation, must provide the corporation's name and number, the year of filing and the date of the last annual meeting of members, and must indicate whether the NFP corporation is or is not a soliciting corporation.

### **Filings required by the CRA**

#### *Income Tax Return*

An NFP corporation is generally required to file a Form T2, Corporation Income Tax Return. However, if an NFP corporation's main purpose is to provide dining, recreational, or sporting facilities, then property held by the organization is considered to be held by a trust, and the return to be filed is the T3RET, Trust Income Tax and Information Return. In either case, the organization will

certainly need to obtain the services of a tax or accounting professional who can determine which return must be filed and ensure that the required return is completed and filed properly.

#### *Information Return*

In some instances, an NPO (meaning both incorporated and unincorporated not-for-profit organizations) will have to file an annual information return with the CRA, but this requirement will generally apply only to larger NPOs. Specifically, an organization may have to file a Form T1044, Non-Profit Organization (NPO) Information Return, if it is an NPO that received income (meaning taxable dividends, interest, rentals, or royalties) of more than \$10,000 during the past year. The filing requirement for that information return is also triggered if the total assets of the organization were more than \$200,000 at the end of the immediately preceding year.

NPOs should also be aware that once an organization has filed an NPO information return for a particular year, it must continue to file that return for each subsequent year, even if its revenue or assets no longer exceed the thresholds which initially triggered the filing requirement.

As is the case where an organization is required to file an income tax return, filing of the T1044 will typically be done by an accountant or other financial professional who is familiar with the financial affairs of the organization.

It may seem from the foregoing that the administrative requirements involved in creating and maintaining an NFP corporation are unduly onerous. However, almost all of the work involved in fulfilling those requirements is a one-time effort taken at the time the company is created. Once incorporation is effected, directors elected, and articles of incorporation and by-laws drafted and approved by the membership, most of the work is done. Thereafter, most NFP corporations will need only to file an annual tax return with the CRA and a one-page annual return with Corporations Canada to maintain their status as NFP corporations — and the benefits which come with that status.