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# Collaboration, Cooperation and Merger in the Canadian Charitable Sector

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# Blumberg Segal LLP

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# Introduction

- Legal information not legal advice
- Views expressed are my own
- Questions during and at end
- Logistics and timing

# Environment

- Competition
- Insufficient resources (money, volunteers) vs. need
- Uncertain resources
- Maximize public benefit of charities
- Reporting requirements
- Desire for greater transparency and accountability
- Technology
- Standards
- Visibility
- National and International activities

# Canadian Charity Sector

- 85,500 Registered Charities
- Charitable Org. (74,868), Public Found. (4,970), Private (4,778)
- 7% of GDP (2.5% if you exclude hospitals and universities)
- 1.4 million full time employees
- 182 billion in revenue

# Canadian Charity Sector

- Government transfers are most important source of revenue
- From 2000 to 2008, the amount of government funding increased by 126%
- Charities revenue from government increased from 54% to 67% of total revenue from 2000 to 2008.
- About 60% of government funding is for hospitals, schools, colleges and universities (which make up 4.3% of charities)
- About 90% of all government funding during this period was transferred to registered charities from the provincial or territorial level.

# Canadian Charity Sector

- 15 charities have revenue over \$1billion (6 have over \$2b)
- From 2000 to 2008 charity sector nearly doubled revenue.
- Total expenditures on charitable programs by charities is increasing compared to admin, fundraising etc.(62% charity in 2003, 73% charity in 2008)
- Charity assets of \$242 billion (2008), an almost 50% increase compared to the amounts reported in 2003.
- 95% of assets are held by less than 20% of all registered charities in Canada.

# Variety of Charities

Every charity is different:

- Objects
- Areas of charitable work
- Risk tolerance
- Public profile
- Donors and level of government support
- Independent vs. affiliated
- Resources
- Values and knowledge
- Local vs. international activities

# Charity Stakeholders

- Members
- Board
- Employees of charity
- Volunteers
- Government (CRA, federal, provincial, and municipal)
- Partners
- Media
- Public
- Donors
- Beneficiaries, clients

# Hard Times

- Needs are greater, funding not keeping up with needs
- Across the board charities doing “well” (some have increased revenues, some decreased)
- “hard times” – compared to whom? I.e. people, businesses.
- ‘Necessity is the mother of invention’
- ‘a crisis is a terrible thing to waste’

# High Level Overview

- Bring in more revenue
- Spend less
- Build reserves, pay down debt vs. spend reserves, increase debt, sell assets
- Diversification between types and sources with each type

# Short Term Ideas When Lose Major Funder

- Close programs
- Cut costs including people, deferring purchases
- Using reserves
- Using self-restricted endowments
- Selling Assets
- Using lines of credit or get loan
- Asking supporters for increased support
- Merge
- Close charity

# Other Ideas

- Have good communication with stakeholders
- Be aware of cash flow and adequacy of cash reserves
- Budgeting – zero based vs. Incremental
- Prepare for the worst, hope for the best
- Time matters – if you have little time cuts will be deeper, impact greater and more risk to charity.
- Evaluate programs – effectiveness, cost
- Should you be charging or charging more for services and effect
- Can costs be trimmed?

# Other Ideas

- Are you using volunteers effectively?
- Are you investing adequately in new technology? Is technology being utilized effectively? Is more training needed
- Outsourcing
- Analyzing Costs and cost recovery
- Insurance – have appropriate coverage
- Good internal controls –prevent mistakes, fraud, theft.
- Collaboration and alliances, sharing assets, space and equipment
- Mergers

# Thoughts

- Less pain if you fix problems sooner
- Know what you can control, what you cannot control and focus on what you can control
- You may be unique, but you are not uniquely unique
- Can other sources of funding be found? (Gov, Earned Income, Fundraising)
- Clean up issues now, no time when dealing with funding cuts, including governance, legal, policies etc.

# What is Governance?

- *Governance* comes from the Greek verb [*kubernáo*] which means *to steer*
- **The process of decision-making and the process by which decisions are implemented (or not implemented)**
- No one size fits all – e.g. small volunteer charity vs. large national charity

<http://www.unescap.org/pdd/prs/ProjectActivities/Ongoing/gg/governance.asp>

# Board Responsibilities – 7 Key Tasks

- a) Setting the mission and strategic objectives, evaluating progress in achieving these objectives;
- b) Making sure the organization operates in a fiscally responsible manner and complies with all laws and regulations applying to it;
- c) Selecting and evaluating the performance of CEO;
- d) “Boundary Spanning”: (i) by bringing the concerns of the outside community and particular constituencies into the organization; and (ii) by representing the organization to the community and constituencies;

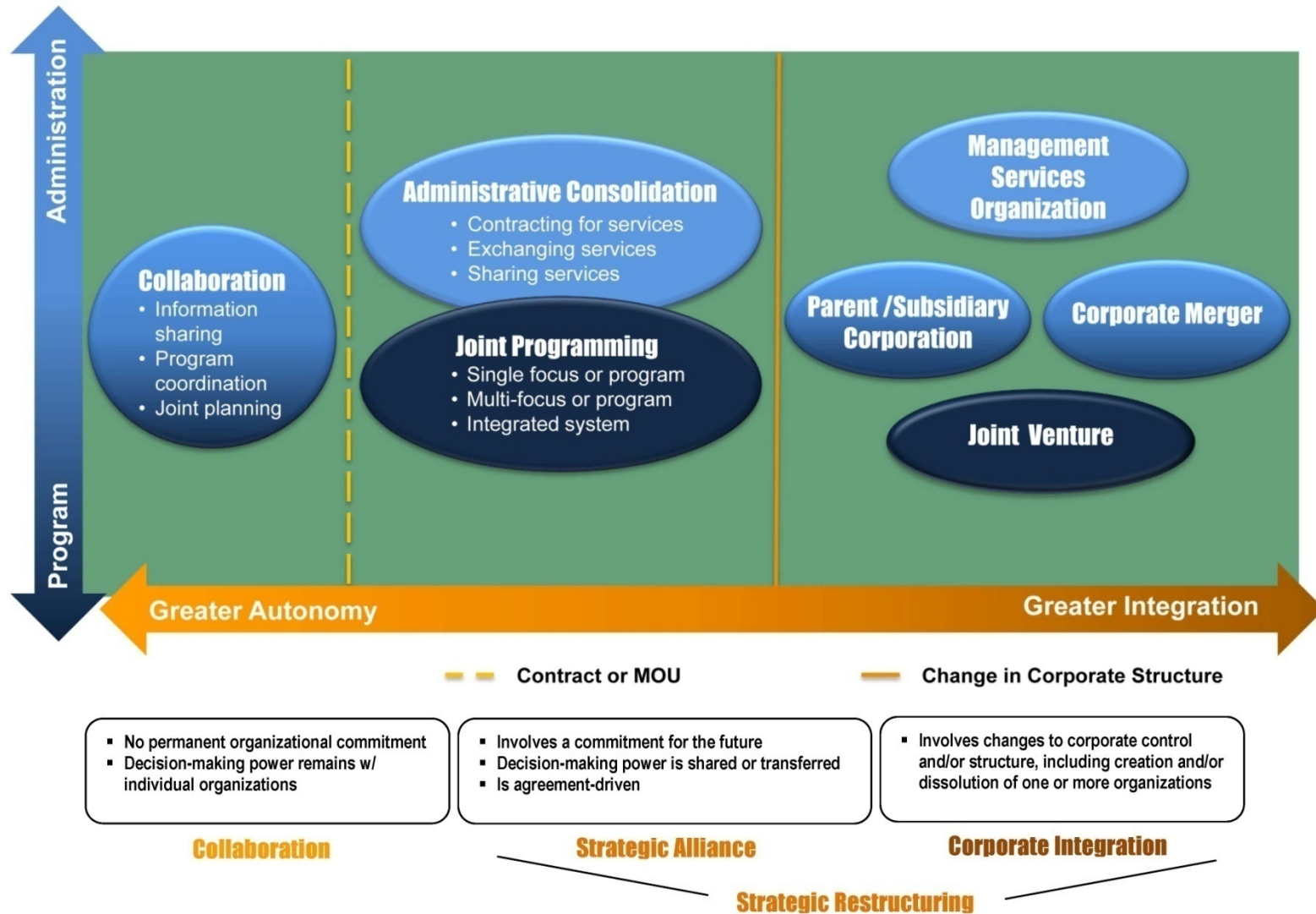
# Board Responsibilities – 7 Key Tasks

- e) Ensuring necessary financial resources;
- f) Ensuring management operates organization as efficiently as possible and uses the best available systems, policies and administrative practices to do so;
- g) Ensuring that the board itself functions as effectively as possible (e.g., finds best people to serve, provides adequate training for members, manages its meetings and committees well).

“Improving Board Performance” by Vic Murray in The Philanthropist  
(Volume13, No.4)

<http://journals.sfu.ca/philanthropist/index.php/phil/article/view/161/161>

## The Partnership Matrix



# Three Scenarios

- Collaboration between two or more Canadian registered charities
- Merger of two Canadian charities
- Collaboration between Canadian charity and non-profit either in Canada or abroad or foreign charity

# Cooperation/Collaboration

- Can be sharing of information, coordination of programs, joint programming, joint fundraising etc.
- Makes a big difference if:
  - Collaboration between qualified donees (eg. 2 or 3 registered charities)
  - Collaboration between qualified donee and non-qualified donee – if transfer of resources from qualified donee to non-qualified donee need direction and control
  - Collaboration between two or more non-qualified donees.

# Merger of two or more Canadian registered charities

# Merger

- most integrated form of cooperation: amalgamation, merger, or consolidation

# Why consider merger?

- Process in which organizations discover that there could be some benefits to collaborating
- Catastrophic event – collaboration is lifeline
- Opportunity to use assets/funding.
- Funder suggests collaboration or merger
- Merger can avoid discussion of winding up an organization
- Merger is progression of partnership

## Why Consider Merger (cont)

- Increasing competition in a number of sectors
- Funders are increasingly requesting that nonprofits and charities work together - from joint programming to merger – avoid duplication, increase efficiency, improve service delivery
- “Merger Bonus” – may receive more funds from funders than the individual organizations did prior to merger.
- Can result in cost savings because of the ability to share resources, exercise greater purchasing power and consolidate duplicate governance structures.

# Why Consider Merger?

- Shakeup organization to make major changes
- Greater demands for accountability, transparency, measurement and evaluation.
- Benefit from the technical, financial, fundraising, and other resources of another organization. As well, a larger staff resulting from a merger can allow for greater specialization.
- Public may feel area is overcrowded
- Greater public profile and credibility, greater resources for fundraising and development, and less confusion in the public's mind about what the organization does.

# Why Consider Merger?

- Many small organizations try to be jacks-of-all-trades and end up being masters of none – want broader and better services.
- Trouble attracting human resources, including staff and volunteers, because of limited opportunities or low profile in the community.
- Staff may be close to exhaustion and burnout. A merger can alleviate this pressure.

# Problems with Collaboration/Mergers

- Emotional baggage and ego
- Jobs on the line
- Organizational culture may not fit (Culture includes attitude to taking on risk, decision-making processes and management style, beneficiary participation, flexibility to change, and theories of change.)
- “merger penalty” - good intentions aside, after the merger the funder may provide the merged entity with less funding than it provided to the individual organizations prior to the merger.

## Problems (cont)

- Distraction
- How will it affect mission
- Trust – were formerly “competitors”
- Jockeying for positions within the merged organization.
- Bigger is not necessarily better
- Restrictions on assets or funding
- Bad merger or collaboration agreements
- Can be expensive – professional costs, loss of goodwill, integration
- Decision paralysis

# Questions for charity merger

1. What are the drivers for merger?
2. What are short, medium and long-term goals of merger?
3. Have you carefully indentified a number of possible merger partners and if not, why not?
4. Is this the right time to merge?
5. Are the merger organizations unincorporated, trusts or incorporated?
6. What are the legal objects of each merger partner? Are they acting currently within objects? Will objects need to be changed?

## Questions for charity merger (cont.)

7. Do the organizations have the legal powers necessary to effect the proposed merger? Do either organization need to modify their governing documents?
8. Have the necessary professional advisors, including a lawyer who is knowledgeable about mergers, been retained to assist and give advice on a merger? Is the lawyer knowledgeable about charity law if one of the parties is a charity?
9. How many voting members are there for each organization? Who are the members and will they support merger? What do the statute and by-laws provide in terms of quorum for a members' meeting and can this be achieved?

## Questions for charity merger (cont.)

10. Who are the stakeholders of each organization and will they support merger?
11. Who is going to be the dominant party or will there be equality?
12. How many board members are there for each party to the merger? How many will there be with the merged entity? What skills, resources, diversity, and connections does each board member bring?
13. Is the merger in the best interest of both organizations? The directors of an organization must be satisfied that the merger is beneficial.
14. How much time will be spent on the merger discussions, and how long will it take for the merger to take place?

# Questions for charity merger (cont.)

15. How many employees are there?

Will all employees move to the merged entity?

How many years has each employee worked for the organization?

Is a review of factors relevant to termination and severance required?

What was last year's total payroll?

If one organization is paying its employees more than the other, will the more "efficient" organization have to raise the amount that it is paying its employees?

Will there be employment law issues, pension liability issues, et cetera?

Will there be redundancies at some point, and will they be handled appropriately by attrition or proper notice or termination and severance payments?

## Questions for charity merger (cont.)

16. Are there any liabilities with respect to either of the parties?
17. Have both organizations been provided with a list of all actual and threatened litigation over the last five years?
18. Has each party reviewed the financial statements and information of the other?
19. Does one or both charities have any special purpose trusts or endowments, and what donor restrictions need to be complied with?
20. What name will the merged entity have, and has it been reserved?

## Questions for charity merger (cont.)

21. Have debts been appropriately identified and dealt with?
22. What are sources of revenue for each organization? Will donors, funders, and earned income be able to continue and be assigned or transferred to the merged entity?
23. Are the organizations' cultures compatible, and is there a fit? Have both parties to the merger successfully completed work together?
24. Is there a communication strategy in place to consult with and communicate with each stakeholder?

## Questions for charity merger (cont.)

25. Is there a plan for implementing the merger?
26. What will the post-merger structure look like?
27. What obligations will the merged entity take on in terms of continuing programs of one or the other organization, if any?
28. Are there any particular consents required for the merger? Are there provincial or federal acts or regulations that could affect the merger such as the *Public Hospitals Act* (Ontario) for a hospital merger? It is important to obtain consents from funders to the merger and obtain commitments with respect to funding. Funding after a merger can be less, the same, or more from a funder, and it is important to know what the effect of the merger will be on a major funder or funders.

# Steps in Canadian Charity Merger

1. Obtain board approval for any negotiations.
2. Have a confidentiality and non-solicitation agreement with any prospective merger partner.
3. Establish a committee or representative from each organization to deal with the merger and establish terms of reference for the committee or representatives.
4. Work together with the other organization to discuss feasibility.

# Steps in Canadian Charity Merger

5. Identify all assets owned by each organization, restrictions on the asset and the ease with which that asset can be transferred to another entity. Assets could include real estate, intellectual property, valuable equipment, et cetera.
6. Identify all liabilities and ongoing obligations including service agreements, leases, employment, funding agreements, and partnership agreements with domestic and foreign partners.
7. Conduct a comprehensive due diligence process on your potential partner to identify any concerns or impediments to merger.

# Mechanics of merger

- Charity A, Charity B, and Charity C
- A, B, and C could amalgamate.
- A could survive, and B and C could transfer their assets to A.
- B could survive, and A and C could transfer their assets to B.
- C could survive, and A and B could transfer their assets to C.
- Two of the corporations can be amalgamated, and the assets of the third one could be transferred into the amalgamated entity.

## Mechanics of merger (cont)

- A new corporation (D) could be set up, and the assets of A, B and C could be transferred into D.
- One of the merger partners could decide it is prepared to merge with only one of the others and not the third.
- All three could decide that merger is not right for them at this time.
- During the process, one or more of the parties could realize that another party might provide better synergies for a merger.

# Look to constating documents

- Trusts - look at the terms of the trust deed to see whether an amendment is possible.
- Unincorporated associations should look at the agreement between the members—usually called the constitution. Consent of all members if merger procedures not in constitution.
- For corporate mergers, references must be made to corporate law and the letters patent and by-laws of the corporation.

# CCA Federal Non-share capital corp

- Federal corporations under the Canada Corporations Act are not allowed to amalgamate. Similarly, a federal corporation and a provincial corporation cannot amalgamate.
- In order for a merger to take place, either a new corporation must be created and the assets from both transferred into it, or the assets of one corporation must be transferred into the other.
- Federal Special Act corporation – may need statute passed

# Ontario Corporations

- Non-share capital corporations of Ontario, under the *Corporations Act* (Ontario), can amalgamate under section 113 of the *Corporations Act* (Ontario).
- This section sets out some limitations and requirements.
- If the nonprofit is an Ontario non-share capital corporation and a charity, but not necessarily a registered charity with the Canada Revenue Agency, then the Ontario Public Guardian and Trustee will review the application for Letters Patent of Amalgamation.

# Alberta Corporations

- Non-share capital corporations under the Alberta Societies Act , can amalgamate under section 32.
- Amalgamation Agreement, special resolutions etc.

# Canada Not-for-profit Corporations Act (CNCA)

- New federal act – will come into force later this year
- Allows for amalgamations (s. 204-210)

# CRA issues with merger

- If a charity and nonprofit are merging, ensure that the activities of the nonprofit are charitable. Also, the nonprofit will have to cease any activities that a registered charity cannot conduct.

# CRA issues with merger

- When Canadian registered charities have relationships with organizations that are not qualified donees under the Income Tax Act (Canada) that are short of amalgamation (e.g., an agency, joint venture, partnership or contractor relationship), the charity needs to be careful that there is no gifting of resources from the charity to the non-qualified donee.
- When it comes to a merger, CRA wants registered charities to comply with their obligations under the *Income Tax Act* (Canada).

# CRA issues with merger

- In the case of amalgamations, one BN is retained and used by the amalgamated body. The other BN(s) will be terminated. The charity will usually be able to choose which BN it retains.
- With mergers, the body proposing to dissolve undergoes voluntary revocation of its registration. The BN of the other remaining organization is not affected. The assets are all transferred to the remaining organization.
- In the case of consolidations, all original bodies are considered to undergo voluntary revocation. The new consolidated body needs to submit an application for registration and, if accepted, will typically be given a new BN.

# CRA issues with merger

- Registered charities that are changing their charity's legal name must ensure that official donation receipts reflect the new name or they could face substantial penalties.

# CRA issues with merger

- After the amalgamation, a copy of the Letters Patent of Amalgamation should be provided to CRA.
- As well, when writing to CRA, indicate which charitable registration number will be kept for the amalgamated entity.
- Ensure that all official donation receipts reflect the name of the amalgamated entity.

## CRA issues with merger

- If you are planning to modify the objects of one or more charities, you may wish to confirm with CRA that the revised objects are appropriate for a registered charity.
- If one of the registered charity corporations is to be dissolved, remember that under the Income Tax Act, a registered charity can only transfer its remaining assets to an eligible donee upon its dissolution. The registered charity cannot transfer its assets to a non-qualified donee, but a non-qualified donee can transfer its assets to a qualified donee.

## CRA issues with merger

- In the case where a Notice of Intention to Revoke a Charity's Registration has been issued, a registered charity can only transfer assets to an eligible donee, rather than qualified donee, during the winding-up period.
- For example, if three health-care institutions that are all charities (or if some are charities) amalgamate, the amalgamated entity would need to be a registered charity whether or not they want to have charitable status.

## CRA issues with merger

- Otherwise, if a charity's registration is revoked, the charity must either pay off its legitimate debts and distribute its remaining assets to an eligible donee within one year of the publication of the Notice of Intent to Revoke in the Canada Gazette or pay a revocation tax in the amount of 100% of the assets. The charity and its directors are responsible for assets that are improperly disposed of.

## CRA issues with merger

- Another example is the merger of a registered charity and a nonprofit in which the registered charity has liabilities that are greater than its assets and these are being assumed by the nonprofit that is not a registered charity. Since the charity does not then really have any remaining assets after it pays off outstanding liabilities, the net assets that are the subject of the revocation tax are nil.

## CRA issues with merger

- In some cases a registered charity has a disbursement quota excess while another registered charity has a disbursement quota shortfall. How will CRA deal with such a situation? Like in the case of a merger where one charity has an excess and another one has a shortfall, it would depend on which one is dissolved, the one with excess or shortfall. CRA would take the position that a merged entity cannot use disbursement excesses created by the original charity (i.e., because it has been dissolved). Based on CRA's definition of "mergers," this also means that if the entity that dissolved had the shortfall the entity with the excess can retain its excess.

## CRA issues with merger

- The same principal holds true for consolidations, because where a new charity is registered and the previous charities are revoked, excesses or shortfalls from the old registered charities will not be transferred to the new entity.
- However, for an amalgamation, where two or more registered charities will continue to exist within the BN of another the excesses and shortfalls will probably be netted out.

# Collaboration with Canadian Non-profit (not registered charity) or Foreign Charity

## Canadian Charity World Divided in Two

- **Qualified donees** – can issue official donation receipts for Income Tax Purposes
- **Non-Qualified donees** – cannot issue official donation receipts

## List of Qualified Donees

- registered charities;
- registered Canadian amateur athletic associations;
- registered national arts service organizations;
- housing corporations in Canada set up exclusively to provide low-cost housing for the aged;

## List of Qualified Donees

- a municipality;
- a municipal or public body performing a function of government in Canada;
- the United Nations and its agencies;
- universities outside Canada with a student body that ordinarily includes students from Canada (these universities are listed in Schedule VIII of the Income Tax Regulations);

## List of Qualified Donees (cont)

- charitable organizations outside Canada to which the Government of Canada has made a gift during the donor's taxation year, or in the 12 months immediately before that period [IC 84-3R5]; and
- the Government of Canada, a province, or a territory.

## How do I know if it is a Qualified donee?

If in doubt check CRA's listing of charities, call CRA, or treat organization as a non-qualified donee.

- **85,000 registered charities** listed at CRA site:  
<http://www.cra-arc.gc.ca/chrts-gvng/chrts/menu-eng.html>
- **Prescribed foreign universities** at Schedule VIII of the Canadian Income Tax Regulations, as provided in section 3503  
<http://laws.justice.gc.ca/en/showdoc/cr/C.R.C.-c.945/sc:8/20090629/en?noCookie#anchorsc:8>
- **A few Charitable organizations** outside Canada to which the Government of Canada has made a gift in last 2 years [IC84-3R5];  
<http://www.cra-arc.gc.ca/E/pub/tp/ic84-3r5/>

# What is a non-qualified donee?

- All organizations other than qualified donees
- They cannot issue official donation receipts

Examples include:

- Foreign charities
- Canadian non-profits with no charitable status
- Businesses
- Bono, Obama, Angelina Jolie

# Why deal with a non-qualified donee?

## Foreign Activities

- You don't have people in Malawi
- You don't have road building equipment in Haiti
- Local people or organizations sometimes can do it quicker, better and more cost effectively

## Canadian Activities

- The best organization to implement charitable project may be a non-profit (non-charity) or a business and not another registered charity

# CRA's Guidance on Foreign Activities

- **Guidance on Canadian Registered Charities Carrying Out Activities Outside Canada**

<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>

- **Bigger Font Version:**

[http://www.globalphilanthropy.ca/images/uploads/Guidance for Canadian Registered Charities Carrying Out Activities Outside Canada - July 8, 2010.pdf](http://www.globalphilanthropy.ca/images/uploads/Guidance%20for%20Canadian%20Registered%20Charities%20Carrying%20Out%20Activities%20Outside%20Canada%20-%20July%208,%202010.pdf)

# “Own Activities” or “Direction And Control”

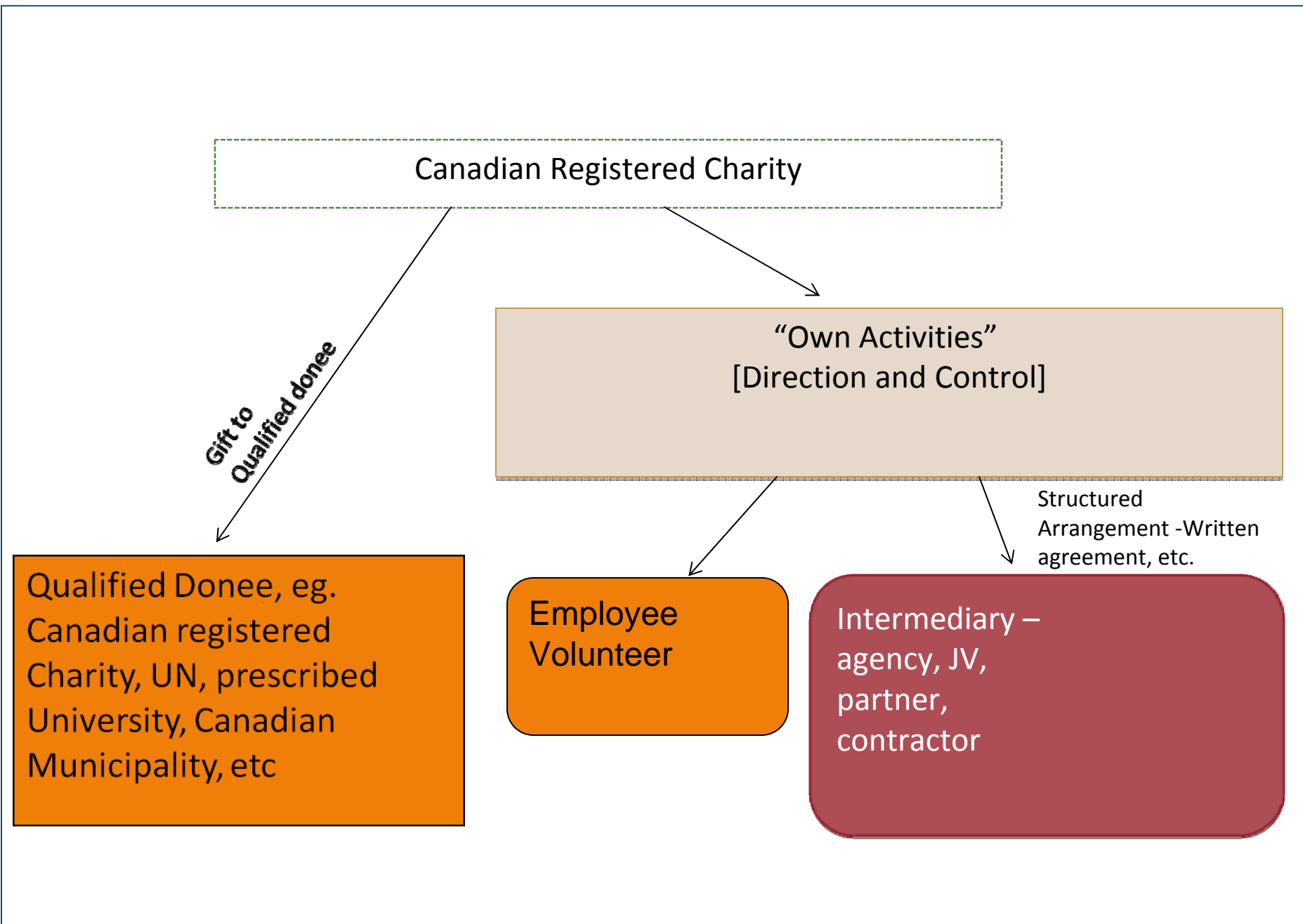
When not working with qualified donee or own staff need to have:

- Due Diligence of Intermediary (investigate)
- Written agreement
- Detailed description of activities
- Monitoring and Supervision
- Ongoing Instruction for changes
- Periodic Transfers
- Separate Activities and Funds
- Books and Records showing above

# Summary

“According to the *Income Tax Act*, a registered charity can only use its resources (for example—funds, personnel, and property) in two ways, whether inside or outside Canada:

- on its own activities (those which are directly under the charity’s control and supervision, and for which it can account for any funds expended); and
- on gifts to qualified donees.”



Canadian Registered Charity

Gift to Qualified donee

Qualified Donee, eg. Canadian registered Charity, UN, prescribed University, Canadian Municipality, etc

“Own Activities” [Direction and Control]

Employee Volunteer

Structured Arrangement - Written agreement, etc.

Intermediary – agency, JV, partner, contractor

# Types of Intermediaries

- Agent
- Joint Venture Participant
- Co-operative Participant
- Contractors

# Thank you!

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