



Top Fallacies about Private Foundations in Canada¹

By Mark Blumberg, Kate Robertson and Lynn Gluckman (April 11, 2016)

When a Canadian registered charity is established, it can be set up as a (i) charitable organization, (ii) public foundation or (iii) private foundation, depending upon its structure, source of funding and operation. There are approximately 5,500 private foundations in Canada. Private foundations have been growing at a higher rate than any other type of Canadian registered charity. Although there are some differences between a private foundation in comparison to charitable organizations and public foundations, over the last two decades those differences have diminished.

That being said, it is quite common in our practice to hear that there is confusion and misunderstanding relating to the operation of a private foundation and the rules that govern it.

Here is a list of some of the top fallacies we see about Canadian private foundations:

- 1. You need to donate millions of dollars to set up a private foundation (i.e. private foundations are for rich people).**

Not really. There has been a lot of media focus on the private foundations of wealthy philanthropists such as Bill Gates and Li Ka-Shing or large for-profit companies such as Mastercard or Walmart. However, most private foundations are set up by individuals, families or corporations with far less wealth or prominence. Some are used as an incorporated vehicle to conduct their philanthropic work and funds are only contributed when needed. One example of

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a private foundation we established was for a family interested in conducting educational activities in Haiti. The incorporated private foundation provided limited liability protection and also a vehicle for the family to organize their philanthropic activities. However, total contributions of the family (and other donors) to the charity was only in the range of about \$30,000 per year and no endowment fund was created.

2. Private foundations are expensive and complicated to establish and operate.

The cost of establishing a private foundation largely depends on how complicated the structure will be and who sets it up. For example, the private foundation could be set up simply to make grants to other Canadian registered charities, or it could be set up to also operate its own activities. A simple private foundation can be established for as little as \$5,000.00. If there are foreign activities involved or other more complicated direct charitable activities, it can be more costly. The actual operation of a private foundation is not any more complicated than other Canadian registered charities and is, in fact, often much simpler to run when it is set up to only provide gifts to other registered charities/qualified donees.

3. Private foundations are set up to give money to other charities and cannot carry on their own activities.

What a private foundation can and cannot do is dictated by its legal objects and the *Income Tax Act* (Canada). If a private foundation has legal objects that only allow it to make gifts to registered charities, then it would be prohibited from conducting its own charitable activities. However, if the legal objects are broader, then the private foundation has more flexibility to conduct its own activities. Whereas a charitable organization should spend more than 50% of its disbursements on charitable activities each year and a public foundation should spend more than 50% of its disbursements on gifts to other registered charities, a private foundation can, for example, spend 90% of its disbursements on gifts to charities in one year and spend 90% on its own charitable activities the next year, if their objects are broad enough to allow for it.

4. Private foundations cannot conduct foreign activities.

Canadian registered charities are allowed to conduct their activities both inside and outside of Canada. However, as mentioned above, private foundations can only conduct activities that fit within their legal objects. If a private foundation has narrow objects such as to only fund qualified donees then it can only fund qualified donees. In general the qualified donees are registered charities in Canada. Almost all foreign charities are not qualified donees. One exception is that there are about

600 prescribed foreign universities that are qualified donees. At least when it comes to certain [prescribed universities outside of Canada](#) it can be exceptionally easy for private foundations to fund those universities. If a private foundation has broad objects that are not limited to a specific jurisdiction such as Canada, they should have the flexibility to be able to conduct foreign activities within the parameters set by the CRA. You might find this article on [Canadian charities conducting International Activities](#) helpful.

5. Private foundations can only receive donations from the family establishing the private foundation.

While many private foundations are supported by a single donor or family, private foundations can generally receive donations from the general public and issue charitable donation receipts for these donations in the same way as other registered charities. There are, however, a small number of private foundations that preclude themselves from taking outside funds in their constating documents.

6. Private foundations cannot fundraise.

Generally, a private foundation can conduct its fundraising in the same way as other registered charities. CRA has a [Fundraising guidance](#) that applies to all registered charities, regardless of their designation.

7. Private foundations can pay for your children's wedding expenses or for gala fundraising tickets for its directors.

This is not acceptable. Private foundations have to be very careful to avoid providing any undue private benefits, excessive compensation or even the possibility that their actions could be perceived as abusing the system.

8. Private foundations can carry out business activities.

One significant difference between private foundations and other registered charities (such as public foundations and charitable organizations) is that private foundations are prohibited from conducting business activities. Public foundations and charitable organizations can carry on related business activities as set out in [CRA Guidance](#), but private foundations cannot conduct any business activities. There is only one narrow exception in that private foundations are now able to invest in limited partnerships as a result of recent changes to the budget. To the extent a private foundation would like to carry on a business activity, the foundation could be re-designated as a charitable organization or public foundation or another charity or vehicle could be established to carry on the business activity. Existing

foundations should occasionally review their structures to ensure that they have enough flexibility to achieve their goals.

9. All board members of a private foundation must be family members.

The board of directors of a private foundation can be structured in several different ways. Some boards may be composed of a majority of or all individuals from the same family. Some boards may be composed of individuals related by close business ties. These people are non-arm's length from each other. On the other hand, some private foundations have arm's length board members where no one is related by family or close business ties. If most of the people on the board of a registered charity are non-arm's length from one another, then the organization must be a private foundation. However, a private foundation is not required to have most of its board at arm's length.

10. Private foundations cannot conduct political activities.

All Canadian registered charities, regardless of their designation, have the ability to engage in non-partisan political activities that are related to their objects, as long as the charity devotes substantially all of its resources to charitable activities. In general, a private foundation can spend 10% or less of its resources on political activities. The scope of a private foundation's ability to conduct political activities will depend on the size and expenditures of the foundation and the scope of its objects. CRA has a [valuable guide](#) on Political Activities for Canadian registered charities. If a private foundation wants to have great impact, it should carefully consider possible involvement in non-partisan political activities. This [brief video](#) from the Maytree Foundation is quite useful in that regard.

11. Private foundations are 'private'.

CRA requires that all Canadian registered charities complete a Form T3010 – Registered Charity Information Return on an annual basis. Most information contained in the T3010 and its schedules (which includes financial information of the charity) is publicly available on the CRA's web site. Private foundations are not excluded from this transparency requirement. If you really want privacy and anonymity there are other better options than private foundations such as working directly with a charitable organization or public foundation or establishing a donor advised funds.

12. When a private foundation makes a gift to a registered charity it should receive an official donation receipt.

This is incorrect. When a Canadian registered charity (irrespective of its designation) provides funds to another Canadian registered charity or other qualified donee it does not receive an official donation receipt. It simply does not need one as the donor charity is tax exempt and therefore could not use the official donation receipt as it will not have taxable income. A private foundation should ensure that, when making a gift to a charity, the charity is currently registered with the Canada Revenue Agency and the private foundation should note the BN number and the amount of the donation so that it can accurately complete its T3010 filing. It is inappropriate for a private foundation to request an official donation receipt and it is inappropriate for another Canadian registered charity to provide a private foundation with such receipt. A charity can provide an acknowledgement or business receipt to the private foundation if it so desires. Additional helpful information about receipting can be found in [Blumbergs' Receipting Kit](#).

13. Once a private foundation is established and approved by the Canada Revenue Agency it cannot change its objects or methods of operation.

This is a common myth. Private foundations, just like other charities, typically can make changes to both their objects and methods of operation. If your private foundation is going to change its objects it will require CRA pre-approval for such a change. It is a good idea to speak to a charity lawyer familiar with CRA requirements and expectations in order to assist you with this process. The process can take between 6 and 9 months depending upon the CRA backlog and the jurisdiction in which the foundation is established.

14. A private foundation is named after the main donor.

Private foundations, just like other charities, can use any name as long as it is not confusing and does not violate certain prescribed rules. While some private foundations have a family's name attached to it, many private foundations use a name that focuses on its mission.

15. A donation to a private foundation needs to be endowed.

Definitely not. Before 2010, if a donor contributed for example \$100,000 to a private foundation and received an official donation receipt for the contribution, the foundation was required to spend \$80,000 the following year on charitable activities or gifts to qualified donees. This was referred to as the "80/20 rule". If you wanted to avoid such a result, you would make a "10-year gift" to the foundation which meant that the capital needed to be endowed for at least 10 years with generally only the income being spent each year. Some 10-year gifts were only restricted for 10 years and others were perpetual endowments. In 2010, the

Income Tax Act was amended to remove the 80/20 rule referenced above. Therefore, there is now no reason when contributing to a private foundation to use 10-year gifts or to endow capital in the foundation even if you want to keep the funds in the foundation for the long term. Some foundations may wish their board to self-restrict funds, but creating a perpetual endowment can often undermine the value, flexibility and impact of the charitable funds in a private foundation.

Obtaining charitable status as a private foundation is a privilege, which comes with many obligations and responsibilities. It is important that private foundations understand their regulatory obligations and comply with the rules. An important part of understanding the regulatory system is also understanding these fallacies which can, in some cases, significantly impede a private foundation's activities and effectiveness.

The reasons for so many fallacies would require another article. However one reason may be that there are certain interest groups who sometimes promote their own philanthropic products by painting an inaccurate picture of private foundations. As some [authors](#) recently noted:

In the North American environment, community foundations and commercially sponsored foundations have criticized private foundations in order to market donor advised funds. Casting private foundations as the straw man to sell another philanthropic option is unfortunate, and occasionally quite misleading. In many cases, the donor who is considering a donor-advised fund should not be considering a private foundation. The scale, structure and responsibility are different, despite certain functional similarities.

If you are planning on establishing a private foundation, it is best to obtain appropriate legal and practical advice before you donate large amounts of money in a way that could significantly hinder the effectiveness of your philanthropic work. The same argument can be made when it comes to depositing large amounts of money in a donor advised fund. I have seen many donors provide large contributions to donor advised funds, not fully understand all the terms and conditions and then a few years later become extremely disappointed that they cannot do what they now want to do. Private foundations are not appropriate for everyone and it is best to establish them only if you really understand how they operate and can be used.

For those who want to have a great degree of control over their philanthropic funds and strategy, private foundations provide a useful vehicle. For Canadians who don't have children or who have more wealth than they wish to provide for their children, private foundations may be a useful tool for dividing your wealth between family and public causes that you care about. There are certainly very generous tax incentives for donating to a private foundation; however, those tax incentives can be achieved through other mechanisms and a private foundation is certainly not the best approach for many philanthropists. If you are going to establish a private foundation, make sure you obtain appropriate advice from counsel who is knowledgeable about the area.

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