

Your Guide to Winding-up a Charity

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At some point during the lifetime of a charity, the directors may consider closing the doors and shutting down. Many charities do this each year, but in making the decision to wind-up and in following through with the winding-up process, careful review should be given to stewardship of the undertaking and assets of the charity, and compliance with all applicable corporate and tax rules. This article will review the key issues which directors should consider.

Generally, there will be three separate processes needed to wind-up:

1. To make a **distribution** of the charity's remaining assets in accordance with the rules applicable to charities;
2. To obtain **voluntary revocation** of charitable status and satisfy all of the requirements of the Charities Directorate of the Canada Revenue Agency; and
3. To arrange for **dissolution** of the corporate entity in accordance with the relevant corporate statute.

For purposes of this article, we'll refer to those as "distribution", "voluntary revocation" and "dissolution", and when we're talking about them non-specifically, we'll call that "winding-up". We'll also refer to the Charities Directorate and the Canada Revenue Agency simply as the "Charities Directorate".

Is Winding-up the Right Choice?

Some of the circumstances that may make directors determine that it is time to wind-up a charity include the following:

- completion of the charitable purpose;
- loss of interest or capacity on the part of the directors; or
- inability to raise sufficient funds or obtain other resources to carry on activities.

If the charitable purpose has been completed, then a wind-up makes sense. However, in other cases, directors might explore whether there is another resolution before taking steps to wind-up the charity.

If there is a loss of interest among the current directors, or too much work for the existing board, then has the charity reached out to see if fresh directors might be interested in continuing the work? Volunteer Manitoba, the Institute of Corporate Directors, and the Manitoba Bar Association are all organizations where director candidates might be found. You might also consider advertising for interested candidates through social media, newspapers, or posting a notice in the community.

If the directors are frustrated due to process or organizational issues, or if there have been problems in coordinating meetings and making decisions, then a governance review may provide ideas for how to better structure the by-laws, meetings or decision-making processes to enable the organization to run more efficiently. It may be beneficial for the chair and other members of the board to read about corporate governance and meeting protocols such as Roberts Rules, or seek some training. Funding may be available from the United Way or others to have a lawyer assist with a governance review, or to have a facilitator work with you to develop and agree on a strategic plan. Volunteer Manitoba and others have training and resources available.

If the organization is simply not able to fund its activities, then it cannot continue to operate. However, has the board canvassed all of the available funding options? Sometimes the things that seem the easiest – events including sales and galas – may be very time intensive and not yield good results. Have you reached out to community foundations? Have you reviewed resources on fundraising? Have you talked to a fundraising expert? Is all of the board committed to contributing, and if so, are there others you could ask to contribute to the cause?

Following through with the Purposes of the Charity

Where there is still a need, there may be a way to restructure the charity so that some or all of its purposes may still be fulfilled. If you have one or more successful programs, is there another like-minded charity which might take them over so that the purposes for which the charity was formed may continue to be fulfilled? Or could you find synergies working together with another charity which might allow space for both of you to continue to operate, either

separately by cooperating with each other, or by formally combining to form one larger entity? Or if you took over a program from another struggling charity, would there be synergies which might enable you to continue to operate its program together with yours in a more efficient way?

The point is that even if it's not possible to continue to operate in the same way as you have been in the past, there may be other ways to fulfill the purposes of the charity. Often, we are stronger together, and there may be synergies and efficiencies to be found simply by asking. Generally, the charitable sector is far more collaborative than competitive. Don't make the decision to close your doors without reaching out to others to explore options.

Formally combining the activities of two or more charities in compliance with both corporate and tax rules can be a technical and complex process, and it would be prudent to consult with legal counsel to effect any changes required to governing documents, and to notify and obtain approval of the Charities Directorate in advance. The terms which Charities Directorate uses for the charity combinations may not be the same as what lawyers use – for example, what Charities Directorate calls a “merger” is legally the transfer of a program from one charity to another followed by the winding-up of the transferor charity. Careful consideration must be given to achieve a structure which works for corporate and charitable law purposes. However, if two charities can decide how they want to work together going forward, then it should be possible for legal counsel to identify the best structure and develop a plan to achieve it.

Dealing with the Assets (or Liabilities) of the Charity

The formal dissolution of a charity should occur after all of its assets (or liabilities) have been distributed. The winding-up process itself cannot make liabilities or debt disappear, and will only lead to problems for the board of directors if assets disappear. As set out below, the Charities Directorate will require the directors demonstrate the orderly distribution of its assets.

When assessing what assets or liabilities need to be dealt with, it is important to consider not only the assets currently in the charity's hands, but any amounts which are owed to the charity, and the value of any capital assets. Similarly, it is important to consider both current and long-term liabilities including any unpaid wages or rent, as well as amounts which will become due such as the unpaid balance to the end of a current lease or other contract. In calculating the

amount which the charity has available to distribute, it would also be prudent to anticipate and set aside a reserve for the expenses of winding-up, including the costs of disposing of or distributing any assets, bank fees, corporate dissolution fees, and final legal and accounting fees.

If the charity is insolvent, in that its assets are not sufficient to pay its debts, then absent an agreement with any creditors to forgive the unpaid amounts, the charity should seek advice from a bankruptcy trustee or lawyer with respect to resolving its debt through a bankruptcy or other arrangement. This advice is beyond the scope of this article.

If, after payment of its debts, the charity has excess assets, then those must be disposed of in accordance with any restrictions contained in the Letters Patent or Articles of Incorporation and By-laws of the charity, and in accordance with the provisions of the *Income Tax Act* (Canada) applicable to charities. The *Income Tax Act* mandates that charities must devote all of their resources to charitable purposes, which generally requires that excess assets must be used in any ongoing charitable activities, or gifted to a charity or another “[qualified donee](#)”. Most charities will have a **dissolution clause** included in the Articles of Incorporation which will dictate how any remaining assets are to be dealt with on a dissolution of the corporation, and this should be reviewed before any decisions are made regarding distribution of assets.

In determining the timing for the distribution of assets and obtaining voluntary revocation, it should be noted that there is more flexibility if the charity distributes its assets prior to requesting that its charitable status be revoked. This is because prior to revocation a charity’s assets may be given to any qualified donee, but once the Notice of Intention to Revoke is issued, excess assets may only be given to an “[eligible donee](#)”. The most significant difference is that there are arm’s length requirements for eligible donees, which may prevent the charity transferring its assets to a related charity.

Dealing with Restricted Funds or Charitable Purpose Trusts

Has the charity accepted funds from a donor which were subject to conditions on their use? Has the charity received funds which were restricted in that they were only to be used for one or more particular charitable purposes? If so, then the charity may hold funds which are subject to a separate **charitable purpose trust**. Caution should be exercised regarding these

funds, because they may continue to be subject to the terms of the trust even after wind-up of the charity.

There may be cases where the board of a charity has “internally” restricted funds, such as setting aside a reserve for purposes of a new building. Such an internal restriction may, subject to the by-laws, be dealt with by the board resolving that the restricted fund will simply be eliminated and paid over to the general funds of the charity. However, that is to be distinguished from “externally” restricted funds, such as where a donor gave funds which were subject to conditions or solely for a particular purpose.

If funds subject to a charitable purpose trust are to be transferred, they must be transferred pursuant to the terms of that trust. In order to avoid breach of trust, the recipient must be made aware of and accept the terms of the trust, and their undertaking to comply with the terms of the trust should be confirmed in writing. If this is not possible, advice should be sought regarding how to appropriately deal with the funds. In Manitoba, absent any wording in the terms of a trust allowing for variation of the trust, the terms of a trust can generally not be amended without the approval of the court.

Voluntary Revocation of Charitable Status

The process of formally giving up charitable status starts by requesting that charitable status be voluntarily revoked by the Charities Directorate. **Revocation** is when a charity's registration is cancelled and, with it, all the privileges of being a registered charity, including the ability to issue charitable donation receipts, cease.

While the Charities Directorate can take away charitable status on its own initiative by revocation for cause, such as where a charity engages in fraud, or fails to file its returns on time, **voluntary revocation** is commenced by the charity itself when it would like to cease to be a charity. Whether or not to grant voluntary revocation is a matter over which the Charities Directorate has discretion, and they will not permit it to be used by a charity to avoid any ongoing compliance or enforcement action.

The request for voluntary revocation is made either online or by letter to the Charities Directorate, providing the charity's name and business number, and requesting voluntary revocation of charitable status. The letter must be dated, and signed by a director or another

person authorized to sign for the charity. The process is described on the Charities Directorate website: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/making-changes/request-voluntary-revocation.html>. It may take a period of months before the Charities Directorate will process the request. However, approximately two weeks before the date of revocation, the Charities Directorate will issue a *Form T2051A Notice of Intention to Revoke a Charity's Registration*, and advise of the proposed date of the revocation. The charity's registration is officially revoked when a notice is published in the [Canada Gazette](#).

The date on the Notice of Intention to Revoke is significant in that it sets the following important timelines:

1. The charity is deemed to have a year end effective on the date of the Notice of Intention to Revoke;
2. The charity's "Winding-up Period" starts the day after the date of the Notice of Intention to Revoke;
3. The charity must file the [Form T2046, Return Where Registration of a Charity is Revoked](#) within one year after the Notice of Intention to Revoke;
4. In addition to the T2046, the charity will normally be required to file two [Form T3010, Registered Charity Information Returns](#). One T3010 will cover the stub period between the time the last T3010 information return was filed and the date of the Notice of Intention to Revoke, and the other will cover the Winding-up Period (the same period covered by the T2046); and
5. The charity's Winding-up Period ends on the earlier of: (i) the date that the T2046 is filed, or (ii) one year after the date of the Notice of Intention to Revoke.

During the charity's Winding-up Period, the charity must distribute all of its remaining assets either by using them in its charitable activities, or by giving them to [eligible donees](#).

The Form T2046 includes a calculation of the **revocation tax**. Refer to the Form, and this Guide: [Guide RC4424, Completing the Tax Return Where Registration of a Charity is Revoked](#). If the T2046 tax return is not filed within one year of the Notice of Intention to Revoke, the Canada Revenue Agency will estimate the revocation tax and issue the revoked charity a Notice of Assessment setting out the amount of revocation tax due.

What is Revocation Tax?

The concept behind revocation tax is that when a charity winds-up, it is not permitted to retain its assets. The revocation tax is thus equal to the total of all of the charity's assets on the date that the Notice of Intention to Revoke is issued plus any amounts received after the notice, reduced by the amount of any assets which are for any remaining charitable activities being undertaken by the charity and by the amount of gifts to "eligible donees" made during the Winding-up Period. The revocation tax may be reduced to zero by the charity using or distributing all of its assets in this manner.

If the charity does not otherwise lawfully dispose of its assets, then everything must be paid as revocation tax at the end of the Winding-up Period. Revocation tax is described on the Charities Directorate website: [Revocation tax and the T2046 tax return](#).

Winding-up the Corporation

Most charities established in Manitoba are incorporated as non-share capital corporations under *The Corporations Act* (Manitoba) or under the *Canada Not-for-Profit Corporations Act*. Assuming that the charity was established as a corporation, once charitable status has been revoked, then the corporation itself should also be dissolved. In Manitoba this can be accomplished by special resolution of the members and filing Articles of Dissolution [https://companiesoffice.gov.mb.ca/forms/articles_dissolution.pdf] with the Manitoba Companies Office. Prior to filing Articles of Dissolution, any outstanding annual returns must also be filed.

Alternatively, the corporation may notify the Companies Office in writing that the corporation is no longer in operation, and request that the corporation be put on the list to be struck from the register of corporations.

Protection of the Directors & Officers

Directors and officers owe a fiduciary duty to the corporation and are responsible to manage its undertaking and affairs, and this extends through its wind-up and dissolution. Directors should ensure that the proper steps are taken through the distribution, voluntary revocation and dissolution stages, including filing all required returns with the Charities Directorate. Among

other risks, it should be noted that if assets of the charity are distributed or sold for less than fair market value to directors or officers prior to its winding-up, there are provisions which allow the Charities Director to recover them.

It is prudent for the directors to review the Articles of Incorporation and By-laws, and ensure that all necessary approvals for the distribution and wind-up are obtained and documented. In addition, following wind-up, records should generally be retained in Canada for a period of six years following the year that the T2046 is filed.

Directors may also discuss with their insurer whether it would be advisable to retain directors' and officers' liability insurance which continues to provide coverage in the event that any unknown liability should come to light following dissolution of the corporation.