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A Joint Briefing Note from the Deputy City Manager & Chief Financial Officer and the City Solicitor

Establishing a Charitable Foundation to run Lotteries to fund programs such as Youth Programs

Issue/Background:

At its meeting of January 26, 2006, the Budget Advisory Committee requested the Deputy City Manager and Chief Financial Officer to submit a Briefing Note to the Budget Advisory Committee wrap-up meeting “on the feasibility of establishing a Charitable Foundation to undertake lotteries to fund youth programs, etc.”

As the issues involved in the feasibility of establishing such a foundation and of such a foundation being permitted to run lotteries are issues involving legal authority, this Briefing Note is being submitted jointly by the Deputy City Manager & Chief Financial Officer and the City Solicitor.

Key Point(s):

A. Legal Considerations

Lotteries:

(a) Prohibition, Exceptions and Licensing Regime:

Subject to certain exceptions, the *Criminal Code of Canada*¹ (the “Criminal Code”) contains a general prohibition against gaming and lotteries, and creates an offence punishable by up to two years imprisonment upon conviction.

Exceptions to this prohibition exist, amongst others, for the province and charitable and religious organizations, pursuant to provincial licence. Charitable and religious organizations may be granted a licence to conduct a lottery if the proceeds from the lottery are used for a charitable or

¹ R.S.C. 1985, c. C-46, s. 206.

religious object or purpose. A body of law has developed defining charitable purposes as being one of the following:

- (i) the relief of poverty;
- (ii) the advancement of education;
- (iii) the advancement of religion; and
- (iv) other charitable purposes beneficial to the community.

Order in Council 2688/93 and the Alcohol and Gaming Commission *Policy Manual* (the “Policy Manual”) outline the lottery licensing requirements in Ontario. The Registrar of Alcohol and Gaming is delegated the authority to grant most lottery licences, while the granting of licences for more minor gaming activities, with strict prize limits, is delegated to municipalities. The process and requirements for obtaining a lottery licence are complex and each application is examined on a case-by-case basis considering the specific circumstances of the applicant organization.

(b) Municipalities:

A municipality itself cannot be granted a licence to run a lottery as the Criminal Code does not create an exception for municipalities from the general prohibition, and a municipality is not a charitable or religious organization and does not have a charitable purpose. The Policy Manual also clearly lists “municipal ... government”, “government agencies or bodies”, and “municipal councils, municipal corporations and their administrative departments” as ineligible organizations for lottery licences in Ontario.

The broad powers contained in Bill 53², should it be enacted in its current form, cannot be interpreted as providing the City the authority to run a lottery, as section 11 of Bill 53 provides that a city by-law is without effect to the extent of any conflict with a federal Act and with an instrument of a legislative nature, including an order. As a city by-law establishing a lottery would conflict with section 206 of the Criminal Code and Ontario Order In Council 2688/93, such a by-law would be of no force and effect.

(c) Organizations associated with Municipalities:

With respect to organizations associated with municipalities, the Policy Manual states that when reviewing the eligibility of such organizations for lottery licences, the extent to which the organization is controlled by the municipality, including the legal, administrative and financial independence of the organization from the municipality, must be reviewed. To be eligible an organization must be completely arm’s length from the municipality and cannot be in any way under the municipality’s control.

If the organization is found to be truly independent from the municipality, the other eligibility criteria required by the Policy Manual to qualify as an eligible organization must be met. To be eligible, an applicant organization may be either a charitable organization or a non-profit

² An Act to revise the City of Toronto Acts, 1997 (Nos. 1 and 2), to amend certain public Acts in relation to municipal powers and to repeal certain private Acts relating to the City of Toronto, received Second Reading, February 13, 2006.

organization with charitable purposes or objects, and must demonstrate that it exists to provide services in one of the charitable classifications described above. Youth programs may qualify as a charitable purpose under the category of other charitable purposes beneficial to the community. This category is further defined in the Policy Manual as including the enhancement of youth.

Another key eligibility criteria is that the organization must have been in existence and provided charitable community services consistent with its primary objects and purposes for at least one year prior to obtaining a lottery licence. This requirement necessitates that an organization have other revenue aside from lottery revenue.

An organization is not required to be incorporated or to be a registered charity within the meaning of the *Income Tax Act*³ (the ITA) to qualify for a lottery licence. As foundations do not generally provide services themselves, they are granted licences in limited circumstances.

The second eligibility criteria relates to the objects of the organization. The objects must also be charitable, and the proceeds of any lottery run by an eligible organization must be used to further the charitable objects of the organization.

The Policy Manual states that proceeds may not be used to fund responsibilities that have been traditionally fulfilled by a government, including a municipal government. This is consistent with the Criminal Code prohibition against municipalities running lotteries themselves. If the objects for which the lottery is raising funds are the same as those of the municipality itself, it may be arguable that the lottery licence is in conflict with the Criminal Code. The Policy Manual suggests, however, that in limited circumstance lottery proceeds may be permitted to be used to fund services over and above those traditionally provided by an otherwise ineligible organization such as a municipality.

Foundation:

Foundations are usually established by way of a trust or a corporation. The ITA defines a “charitable foundation” as a corporation or a trust which is constituted and operated exclusively for charitable purposes.

While it is not free from doubt, under current legislative authority the City could arguably establish a foundation, but not by way of incorporation. The *Municipal Act, 2001*⁴ allows the City to incorporate corporations only in accordance with regulations, and the current corporations regulation does not provide authority to incorporate a foundation. However, it is arguable that if the purposes of the foundation were within the City’s spheres of jurisdiction, the City’s natural person powers would enable the City to establish a foundation by way of a trust.

The City’s authority to establish a foundation by corporation may be enhanced by the provisions of Bill 53, should it be enacted, as Bill 53 gives the City broad powers to establish a corporation which powers must, however, be exercised in accordance with such conditions and restrictions as

³ RSC 1985, c. C-1

⁴ S.O. 2001, c. 25.

may be prescribed by regulation. As no such regulations have to date been prescribed, it is too early to determine whether the City's power to incorporate a foundation would be restricted.

Regardless, however, of the City's authority to establish a foundation, if the foundation is to obtain a licence to run a lottery in Ontario, it must be found to be independent from the City. For example, such factors as the appointment of Council members or City officials to the foundation's board of directors, the City providing staff to the foundation, or the City providing a budget for the foundation, would all contribute to the foundation being found not to have the necessary independence from the City.

The foundation would also have to meet the other tests for a lottery licence as set out above, including having other revenue sources and having sufficient charitable objectives. As discussed above, lottery proceeds cannot be used to fund responsibilities that have been traditionally provided by the City itself.

In any event, it must be remembered that each application for a lottery licence will be considered on a case-by-case basis by the Registrar of Alcohol and Gaming, and it is very difficult to ascertain in advance exactly what structure may allow a foundation, operating at arm's length from the City, to be granted a lottery licence, and what services may be funded by the proceeds of such a lottery.

If the foundation were also intended to engage in other fund-raising activities by attracting donations, it would require registration as a registered charity under the ITA in order to provide tax receipts to donors. The process and requirements of such a registration are beyond the scope of this Briefing Note and are similarly complex to those of the lottery licensing regime.

B. Financial/Administrative Considerations:

The key financial and administrative conditions described above and as prescribed in the Alcohol and Gaming Commission Policy Manual and the Criminal Code of Canada, are repeated below, noting that each application for a lottery licence may be considered on a case-by-case basis by the Registrar of Alcohol and Gaming:

- (i) the proceeds from the lotteries may only be used for new or incremental services not currently being provided by the City
- (ii) the foundation must be arm's length from the City's operations
- (iii) the foundation must be in existence and operating for at least one year prior to obtaining a lottery licence
- (iv) the foundation must have other revenue aside from lottery revenue but not from the City's budget, such as funds raised through donations

Additionally, should the City be legally able to run a lottery, a business risk analysis should be done to confirm the financial feasibility of the foundation and lottery, addressing issues such as:

- (i) potential market for ticket sales
- (ii) potential for other sources of revenues (other than lottery proceeds, such as donations)

- (iii) start up costs
- (iv) cost of marketing and administration
- (v) the competitive environment re existing lotteries.

It is difficult to ascertain at this time whether a lottery operation run by a foundation would be financially viable. A key eligibility criterion established by the Alcohol and Gaming Commission in its Policy Manual requires that a charitable foundation must be in existence for at least one year, which suggests that the lottery foundation must attain financial sustainability based on its other eligible revenues, before a lottery licence is granted. Consequently, should the foundation meet all conditions and achieve the desired results, the lottery proceeds would not be expected to be generated before 2008 at the earliest.

Examples of charitable lotteries currently operating in Toronto include:

- (i) Princess Margaret Hospital Foundation
- (ii) Canadian National Institute for the Blind
- (iii) Canadian Cancer Society Lottery
- (iv) Canadian Red Cross Lottery.

The following financial results are indicative of a successful example in the Toronto lottery market for charitable purposes, and illustrate that significant revenues can be derived from a successful lottery operation.

Princess Margaret Hospital Foundation	\$ Million				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Lottery revenues (net of prizes, expenses)	13.1	16.4	16.9	14.9	13.1
Fundraising revenue (net of expenses)	13.2	21.1	16.2	18.2	20.4
Grants (University Health Network)	-	-	-	38.7	-
<u>Investments</u>	<u>3.2</u>	<u>4.5</u>	<u>4.9</u>	<u>- 1.1</u>	<u>14.8</u>
Total Net Revenues	29.5	42.0	38.0	70.7	56.8
Overhead Expenses	1.8	2.2	2.6	3.1	3.7
Overhead Expense / Net Revenue (%)	6.2%	5.3%	6.9%	9.8%	6.5%

Source: 2004 Tribute Report, Princess Margaret Hospital Foundation
Report to the Donors for the period April 1, 2003 to March 31, 2004.

Although these are not directly related to the lotteries run by the charitable foundations, the general behavioural characteristics of the lottery clientele often show similarities. The experience from the lotteries run by the Ontario Lottery & Gaming Corporation underscore the pervasiveness of lotteries in Ontario society:

- (i) 66% of all Ontario adults (18+) play or have played lottery games;
- (ii) 26% of all Ontario adults play lotteries at least once a week;
- (iii) Lottery play is even across all regions of the Province of Ontario;
- (iv) People with lower incomes are less likely to play, and spend less when they do play, than any other income group.

Nevertheless, charitable lotteries are subject to business risk, primarily associated with the risk of insufficient ticket sales. Accordingly, not all lottery initiatives are successful and some have been abandoned after obtaining poor results. For example, a sports lottery in New Brunswick was abandoned after fourteen weeks. Therefore, not only would the City's entry into such a market place entail risk of failure, but success by the City might occur at the expense of market share currently enjoyed by existing participants.

Conclusion:

The City is prohibited by the Criminal Code from running a lottery itself. Any request to allow the City to run lotteries directly, would require amendment to the Federally enacted Criminal Code.

If the City were to establish a truly arm's length foundation with sufficient charitable purposes and objectives which met all the other criteria of the Policy Manual, the Provincial Registrar of Alcohol and Gaming may, at his or her discretion, grant a lottery licence to such a foundation. Various circumstances described in part in this Briefing Note, however, would require careful examination to determine eligibility, including the independence of the foundation from the City and the proposed use of any lottery proceeds.

In addition, the Foundation would need to develop a business plan that assesses the potential for a financially successful foundation and lottery operation, taking into consideration the various risks. If a successful venture were launched, the Foundation would not be in a position to expend lottery proceeds until 2008 at the earliest, in part due to the eligibility rules of the Alcohol and Gaming Commission.

The issue of a charitable foundation to run lotteries will be addressed as part of a future review and new revenue analysis under the *City of Toronto Act*.

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