TAB 7

Recent Developments in The Charitable Sector

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Continuing Professional Development

RECENT DEVELOPMENTS IN THE CHARITABLE SECTOR*

By

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RECENT DEVELOPMENTS IN THE CHARITABLE SECTOR
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INTRODUCTION

The charitable sector in Canada has seen a number of important legislative, regulatory and common law developments during the last year which have significantly impacted how charities will operate both in Canada and abroad. The following article provides a brief summary of some of these developments, including recent changes under the *Income Tax Act* (Canada)[1] (the "ITA") and new policies and publications from the Charities Directorate of the Canada Revenue Agency ("CRA")[2].

This paper is intended to provide a high level discussion of some of the recent developments in the charitable sector as they relate to estate planners. The following topics will be discussed:

1. The Disbursement Quota Reform;
2. The New CRA Fundraising Guidance
3. Foreign Activities: Registered Charities Operating Outside Canada;
4. Corporate Statutes Affecting Charities
    A. Canada Not-for-Profit Corporations Act
    B. Bill 65: Not-for-Profit Corporations Act, 2010 (Ontario)
5. Gifts by Will;
6. Gifting Strategies: Personal Giving vs. Corporate Giving; and
7. Flow Through Shares.

1. DISBURSEMENT QUOTA REFORM

Federal Budget 2010 – Amendments to the Disbursement Quota Regime

The Federal Budget 2010 and its accompanying legislation has introduced significant changes to the disbursement quota obligations imposed on registered charities pursuant to the provisions of the ITA. These changes have been met with great interest and relief by the charitable sector, which has struggled with an increasingly complex and onerous disbursement quota regime.

A. Background

The ITA provides that registered charities must satisfy their "disbursement quota" ("DQ") in each year in order to maintain their charitable registration. The DQ is a prescribed amount that registered charities must expend each year in a charitable capacity on their own charitable activities or by way of gifts to qualified donees (generally other charities).

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[1] R.S.C. 1985, c. 1 (5th Supp.) as amended, (hereinafter, the "ITA").

[2] Charities Directorate of Canada Revenue Agency, online: www.cra-arc.gc.ca/tax/charities.

The existing disbursement quota regime was originally introduced in 1976 to ensure that registered charities devoted a significant portion of their resources to charitable activities. It was intended to discourage registered charities from spending excessive amounts on fundraising and from accumulating excessive capital.

Briefly, the existing DQ of registered charities, whether they are charitable organizations, public foundations or private foundations, consists of the aggregate of the following:

a) 80% of all donations receipted in the previous year;
b) 80% of all gifts from other registered charities (or in the case of private foundations, 100% of all such gifts); and
c) 3.5% of the value of all property not used in charitable activities or administration in excess of $25,000.

Certain types of property are excluded from the above-noted 80% requirement. These include:

a) "enduring property", such as gifts made subject to a trust or a direction that the capital be held for at least 10 years (also known as "ten year gifts"), bequests, and gifts of proceeds of life insurance, RRSPs and RRIFs; and
b) "specified gifts", which are a particular type of inter-charity gift that allow registered charities with disbursement excesses to assist registered charities with disbursement shortfalls. The "transferor" charity which distributes a specified gift to another charity is not able to use the amount distributed in the satisfaction of its DQ requirement and the "transferee" charity does not have to include the amount received when determining its DQ requirement.

In addition, the concept of the "capital gains pool" allows registered charities to encroach on the realized capital gains from enduring property, i.e., 10 year gifts, to meet their 3.5% DQ obligations.

Over the years there has been much criticism of the disbursement quota regime, both for its complexity and difficulty, and for its disparate impact on registered charities. The government's commentary introducing Federal Budget 2010 notes that the impact of the existing disbursement quota regime "can vary considerably, for reasons unrelated to the manner in which a charity conducts its charitable activities." For example, the existing regime requires registered charities to either expend the bulk of the gifts for which receipts were issued or to hold the capital of such gifts for specified periods of time. As a result, the requirements of this regime have often been in conflict with the program needs and planning goals of registered charities and have been particularly difficult for those organizations whose income is derived primarily from receipted donations.

The introduction by the CRA of a comprehensive fundraising guidance on June 11, 2009 (discussed below in section 2 in greater detail) also complicated the existing DQ regime. Among other matters, this guidance provides charities with examples of acceptable and unacceptable ratios of fundraising to charitable expenditures. The suggested fundraising ratios provided in the guidance are as follows: (i) less than 35% fundraising expenses, little CRA concern; (ii) greater than 35% fundraising expenses, some CRA concern; and (iii) above 70% fundraising expenses, significant CRA concern and potential deregistration. The confusion arises from the fact that these percentages differ from the 80%-20% disbursement quota ratios. In addition, the introduction of this guidance seemed to ameliorate some of the policy concerns behind the 80% disbursement quota requirement.

In July 2009, the National Charities and Not For Profit Law Section of the Canadian Bar Association (the "CBA") submitted a *Concept Paper on the Reform of the Disbursement Quota Regime* (the "Concept Paper") to the Department of Finance. The CBA Concept Paper identified four specific regulatory objectives of the current DQ regime: (i) current gifts disbursement; (ii) anti-accumulation; (iii) efficiency; and (iv) fundraising efficiency.

The Concept Paper proposed that the objectives of a DQ regime should be to prevent undue accumulation of donations, income and capital. The Concept Paper noted that the current regime is not an effective instrument to curb fundraising costs and achieve administrative efficiency. It further noted that the fourth objective is better achieved by guidance and the third objective could be monitored through increased transparency.

A number of recommendations for reform were put forward including: (i) repeal of the 80% DQ; and (ii) modification of the 3.5% DQ, with consequent simplification of the DQ calculation and repeal of the complex DQ concepts in the ITA. These recommendations were supported by Imagine Canada, the Canadian Association of Gift Planners and other organizations during hearings before the House of Commons Standing Committee on Finance in the fall of 2009.

B. Federal Budget 2010 Changes (Draft Legislation August 27, 2010)

In response to these concerns, as well as others raised by the charitable sector, the Federal Budget 2010, and its accompanying draft legislation tabled on August 27, 2010 and Notice of Ways and Means Motion tabled September 28, 2010[3], has proposed the following significant changes be made to the DQ obligations of registered charities. These changes will apply to charities' fiscal years ending on or after March 4, 2010.

i) The Elimination of the Charitable Expenditure (80%) Rule

The charitable expenditure rule (i.e., the requirement that 80% of all receipted gifts received in the previous year must be expended) will be eliminated. This means that a number of very complex concepts will no longer be required to calculate the disbursement quota of registered charities, including the terms "enduring property", "specified gifts" and "capital gains pool".

Specified exclusions from the calculation of the base of the 3.5% disbursement quota rule will also be eliminated, as these provisions were meant to ensure that funds subject to the 80% disbursement quota rule were also not subject to the 3.5% rule.

ii) The Modification of the Capital Accumulation (3.5%) Rule

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[3] Legislative Proposals relating to the Income Tax Act, the Air Travellers Security Charge Act, the Excise Act, 2001, and the Excise Tax Act, August 27, 2010 and Notice of Ways and Means Motion, September 28, 2010.

The capital accumulation rule (i.e., the requirement that 3.5% of all assets not currently used in charitable programs or administration be disbursed if such assets exceed $25,000) will be modified.

The $25,000 threshold for when this requirement is imposed will be increased to $100,000 for charitable organizations. As the Federal Budget 2010 materials suggest, this increase will "reduce the compliance burden on small charitable organizations and provide them with greater ability to maintain reserves to deal with contingencies." The threshold for charitable foundations will remain at $25,000.

In addition, in order to allow registered charities to accumulate property for particular projects, the CRA will be given the discretion to exclude such accumulated property from the 3.5% disbursement quota obligation.

iii)The Imposition of Anti-Avoidance Rules and Associated Penalty Provisions

The anti-avoidance rules will be amended as a result of the disbursement quota changes to prevent charities from avoiding or delaying expenditures on charitable activities.

The anti-avoidance rules will be broadened such that they will extend to transactions where "it can be reasonably considered that a purpose of the transaction was to avoid or unduly delay the expenditure of amounts on charitable activities." Registered charities that engage in such transactions will be liable for penalties equal to 110% of the amount of the expenditure avoided or delayed and may be subject to revocation.

Provisions will be introduced to ensure that amounts transferred between non-arm's length registered charities will only be able to be used to satisfy the disbursement quota obligations of one of the registered charities, subject to the exception for "designated gifts".

These provisions will require the recipient charity to either spend the entire amount it receives on its own charitable activities or to transfer the amount to an arm's length qualified donee in the current or subsequent taxation year. Registered charities that are in violation of such provisions will be liable for penalties equal to 110% of the amount received from the non arm's length charity but not expended in the current or subsequent taxation year and may be subject to revocation.

Alternatively, the registered charity that transfers the funds will be able to elect that its gift not count toward satisfying its own disbursement quota. This will relieve the recipient charity from being required to make the aforementioned disbursements.

The purpose of the exception for designated gifts is to enable the non-arm's length inter-charity transfer of assets without requiring an expenditure in the year the transfer is received or the following year. The donor charity will be able to designate all or a portion of an inter-charity non-arm's length gift in Form T3010B but will not be able to apply the gift to count toward meeting its DQ. The recipient charity will not be required to expend the amount in the year the transfer is received or the following year. If the amount is expended on charitable activities or on gifts to arm's length qualified donees, the amount expended will count towards meeting its DQ.

The proposed amendments to the rules governing non-arm's length inter-charity gifts have left some issues outstanding that will need to be addressed. For instance, while the rules reference fair market value of property, they do not indicate when fair market value is to be determined and how to address a sale of property or an increase or decrease in the value of the property.

iv) Transitional Assistance

The CRA will be making several administrative changes in response to the changes to the DQ. The CRA will be providing guidance to registered charities on how to determine their disbursement quotas and a revised Registered Charity Information Return has been developed in response to the new regime. This new Form T3010-1 will be used by charities with fiscal periods ending on or after December 1, 2010 and will be mailed to charities early in January 2011.

The private benefit provisions, associated CRA policies and the CRA's Fundraising Guidance are additional tools dedicated to assist charities in determining what is or is not a charitable purpose or activity.

C. Impact of Disbursement Quota Changes

The significant changes to the DQ regime introduced in Federal Budget 2010 will be of great benefit to registered charities.

The expense and time spent by registered charities in order to comply with the DQ regime will hopefully be greatly reduced. In addition, registered charities will no longer have to insert restrictive conditions in endowment agreements in order to allow the gifts comprising the endowment to constitute "enduring property". In the future one can expect to see more flexible terms and conditions in endowment agreements which in turn will lead to greater ease of administration of such gifts in the future.

For example, endowment agreements under the existing DQ regime have had to restrict the ability of the charity to encroach on capital for a period of at least ten years from the date of the donation in order for the endowed gift to qualify as enduring property. As a result, the disbursement of the income and capital of the fund has had to be dealt with separately in the terms of the endowment agreement. Under the new regime, endowment agreements can be drafted so that specific references to income and capital are removed in favour of provisions that allow for a total return investment and payout strategy (i.e., a combination of capital appreciation and income returns).

In addition, now that charities will no longer have to struggle with structuring long-term gifts and endowment funds to comply with complex ITA language related to enduring property, both charities and donors will need to carefully consider whether long term gifts or gifts held "in perpetuity" are either required or desirable. For most charities, the key to most long-term gift planning will be flexibility, provided that the donor's wishes can be otherwise satisfied.

It should also be noted that as a result of the DQ reform introduced in Federal Budget 2010, existing donor agreements should be reviewed to determine whether it is possible for the charity to encroach on the capital of the gift either prior to or after the requisite ten year hold period. In addition, template documents used by charities, such as donor agreements and policy statements (e.g., gift acceptance, investment and distribution policies) should be reviewed and updated. For example, references to concepts such as enduring property, ten-year gifts and the capital gains pool can be removed from donor agreements. Education of both staff and donors will also be necessary and communication materials, such as the charity's website, newsletters etc., will need to be updated.

Notwithstanding the significant simplification of the DQ regime resulting from Federal Budget 2010, registered charities will still need to continue to be diligent about their compliance with all applicable rules and regulations. In particular, the content of the new legislative requirements, and the manner in which they are interpreted by the CRA (and in particular the anti-avoidance provisions), will have to be monitored in order to ensure that the remaining DQ regime continues to be complied with on a going forward basis. In this regard, the transitional policy statements that will be introduced by the CRA will have to be reviewed carefully. For example, there are still questions as to whether those charities which have accumulated DQ excesses can utilize them. Finally, it appears likely that the abolition of the 80% disbursement quota requirement will increase the importance of the CRA's Guidance as an audit and compliance tool. Registered charities should pay careful attention to ensuring that they satisfy the requirements set out in these guidelines on an ongoing basis.

2. THE NEW CRA FUNDRAISING GUIDANCE

A. Background of New Proposed Fundraising Policy

The allocation of expenses between those that are charitable and those that are related to fundraising has raised issues for charities when in engaging in charitable activities and completing annual returns. In response to requests from the charitable sector for guidance on how to allocate expenses and in response to public concerns for more accountability from charities with respect to their fundraising, the CRA has issued guidance on fundraising by registered charities (CPS-028) on June 11, 2009.[4]

On March 31, 2008 the CRA released its proposed Policy on Fundraising and on June 26, 2008 the CRA released a 30-page background information document explaining the proposed Policy. After public consultation, on June 11, 2009 the guidance was released together with an additional Information document (collectively, the "Fundraising Guidance").

The Fundraising Guidance provides guidance on the proper treatment of fundraising under the ITA and the common law, and includes:

- Distinguishing between fundraising and other expenditures;
- Allocating expenditures for the purposes of reporting them on Form T3010;

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[4] CRA Guidance: Fundraising by Registered Charities, CPS – 028.

- Dealing with activities that have more than one purpose; and

- Understanding how the CRA assesses what is an acceptable fundraising activity, what may preclude registration or what may result in a sanction, penalty or revocation.

CRA has advised that the Fundraising Guidance does not represent a new policy position but a confirmation of its existing policies. The Guidance applies to all registered charities and to receipted and non-receipted fundraising income. It should be noted that the Fundraising Guidance provides general guidelines only and individual cases will be decided on the specific facts of the situation.

The Fundraising Guidance does not directly relieve a charity from having to meet all of the other requirements of the ITA, nor does it address business or related business activities[5], or fundraising to support terrorism[6].

B. Overview of Policy

Fundraising and Charitable Purposes

All registered charities are required to have exclusively charitable purposes. The CRA takes the position that fundraising, whether taken as a purpose or as an activity, is not in and of itself charitable. Consequently, direct costs of fundraising cannot be reported as charitable expenditures on Form T3010B. Fundraising activities which are attached to activities primarily directed at achieving a charitable purpose can be allocated between charitable and fundraising expenses for the purposes of reporting.

What is Fundraising?

Fundraising is any activity that is carried out by the charity, or someone acting on its behalf, that:

- Includes a "solicitation for support" for cash or in-kind donations (solicitations for support include sales of goods or services to raise funds);

- Is part of the research and planning for future solicitations of support; or

- Is related to a solicitation of support (efforts to raise the profile of a charity, donor stewardship, donor recognition etc.)

These activities will be classified as "fundraising" even if no donation receipt is issued for the transaction.

"Solicitation of support" is not explicitly defined in the Fundraising Guidance, but CRA's background information document shows that it takes a relatively broad view and generally any activity intended to encourage future donations will be caught.

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[5] See CPS-019, "What is a Related Business" and CPC-001 "Related Business".

[6] See Registered Charities Newsletters No. 12 and No. 20.

Fundraising does not include requests for funding from government or from other registered charities. The operation of a related business or recruitment of volunteers will likewise not be considered fundraising.

If a receipt is issued for any part of a transaction, the activity is deemed to be a solicitation of support and therefore the costs associated with the entire activity must be automatically allocated to fundraising expenditures.

Implied Solicitations of Support

"Donor Recognition" is the acknowledgement or thanking of a person who has made a gift. It must be reported as fundraising unless it is of nominal value; the CRA considers per donor cost of $75 or 10% of the donation (whichever is less) as nominal. If the per donor cost is nominal and is not reported as a fundraising expense, it must still be reported as an administrative expense.

"Donor Stewardship" means the investing of resources in relationships with past donors to prompt additional gifts, inclusive of providing donors with access to information, services or privileges that are not available to others. Stewardship is considered to be a solicitation of support and must be reported as fundraising.

The sale of goods or services will always constitute a solicitation of support unless it serves the charity's beneficiaries, directly fulfills a charitable purpose, or is sold on a cost-recovery basis. The offering of a good or service as part of the solicitation message (in order to encourage a donation) will also be found to be a solicitation of support.

If a charity partners with a business or other non-charity to offer a good or service on the basis that a portion of the proceeds will be paid to the charity, any costs incurred by the charity with respect to the activity will be considered fundraising expenses.

Membership programs can be considered a solicitation of support if membership is associated with substantive benefits (i.e., more than being able to vote or receive a newsletter).

What is Prohibited Fundraising?

Certain types of prohibited conduct related to fundraising may result in penalties, sanctions or revocation of a registered charity's status, including fundraising conduct that:

- Is illegal or contrary to public policy. Illegal activities include those that are criminally fraudulent, or violate federal or provincial statutes governing charitable fundraising, charitable gaming, the use of charitable property, or consumer protection. Activities which may be contrary to public policy include those which result in incontestable harm to the public interest or if they do not comply with government rules, directives, and regulations;

- Is a main or independent purpose of the charity. This is typically determined in reference to a collateral purpose - when more of a charity's time, effort, and other resources are devoted to its fundraising rather than to carrying out its broader charitable purposes, this is a strong indication that fundraising is a collateral purpose;

- Results in more than an incidental or proportionate private benefit to individuals or corporations. Private benefit is generally incidental and proportionate where the amount or percentage of gain to individuals or corporations is not excessive relative to the benefit to the public and private benefit must be necessary to be considered incidental; and/or

- Is misleading or deceptive. Representations made by a charity, and those acting on its behalf, must be fair, truthful, accurate, and complete. In particular, registered charities must not misrepresent which charity will receive the donation, the geographic area in which the charity operates, the type of work it does, or the percentage of funds raised that will go to charitable work.

The background information document contains additional information pertaining to each of these categories.

Allocation and Reporting of Fundraising Expenses

The Fundraising Guidance explains two relevant issues regarding the allocation of fundraising expenses. First, the Guidance provides guidelines regarding when an activity that includes a solicitation for support will not be considered a fundraising activity and when it does not have to be allocated as such on the charity's Form T3010. Second, it outlines the CRA's approach to reviewing the fundraising expenditures of charities and determining whether the costs are reasonable.

Every charity is required to report all fundraising expenses on its Form T3010B. Fundraising expenses include all costs related to any activity that includes a solicitation of support (or is undertaken as part of the planning and preparation for future solicitations of support), unless it can be demonstrated that the "activity" would have been undertaken whether or not it included a solicitation of support.

A fundraising activity can be a single action, such as a magazine advertisement, or a series of related actions, such as a capital campaign. The charity may decide what it considers to be a separate activity so long as it can reasonably be treated as discreet. For example, external activities may include soliciting donations through telemarketing, direct mail, holding events and/or distributing information through the media or the charity's publications, whereas internal activities may include researching prospective donors or hiring fundraisers.

A charity may be able to demonstrate that an activity would have been undertaken without a solicitation of support by satisfying either one of The Substantially All Test ("Test A") or The Four Part Test ("Test B").

Test A – The Substantially All Test

Under this test, an activity will be found to have been undertaken without a solicitation of support if substantially all of the activity advances an objective other than fundraising. For these purposes, "substantially all" is considered to be 90% or more of the activity. Generally, the determination will be based on the proportion of fundraising content to the rest of the activity. The prominence of the fundraising content in the activity and the resources devoted to it may also be considered. For these purposes, "resources" includes the total of the charity's financial assets, as well as everything the charity can use to further its purposes, such as staff, directors, premises and equipment. If Test A is satisfied – the charity will be able to report all of the expenditures of the activity on its Form T3010 under charitable expenditures, management and administration, political activity or other expenditures as applicable.

Test B – Four Part Test

If the Part A test is not met, a charity can still show that the activity would have been taken without the solicitation of support if the answer to the following questions is "no":

1. Was the main objective of the activity fundraising?

2. Did the activity include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise?

3. Was the audience for the activity selected because of their ability to give?

4. Was commission-based remuneration or compensation derived from the number or amount of donations used?

If Test B is satisfied (i.e., all of the answers to the above questions are "no"), the charity may allocate a portion of the costs as non-fundraising expenses and a portion as fundraising expenses on its Form T3010.

CRA's background information document provides additional guidance as to how to determine whether the main objective of the activity is fundraising (question 1 above). The background information document breaks this question down into two sub-questions:

(a) Do the resources devoted to the fundraising component of the activity indicate that the main objective is fundraising?

Generally if the largest portion of resources is devoted to an activity related to fundraising, the main objective of the activity is fundraising, even if some resources are used for other objectives. The amount of resources devoted to an activity is determined by the content and costs associated with carrying out the activity – see Test A "The Substantially All Test". When the main objective of the activity is fundraising, the general rule is that all the costs must be allocated as fundraising expenses.

(b) Does the nature of the activity indicate that the main objective is fundraising?

For instance, a free paid service announcement is generally not considered to have fundraising as its main objective.

A paid advertisement is usually considered to have fundraising as its main objective unless it focuses primarily on aspects of the charity's work other than fundraising – such as promotion of the charity's programs or services to beneficiaries or potential beneficiaries – and then it will not be considered fundraising.

An infomercial, and telemarketing, as such terms are defined for Canadian Radio-television and Telecommunications Commission ("CRTC") purposes, are considered to be predominately fundraising.

Certain undertakings will always be considered to be fundraising, including activities with content relating to charitable gaming and activities with content related to products or services being sold as a fundraiser by or on behalf of the charity.

The content of certain initiatives that are carried out to fulfill a charity's purposes may be hard to separate from a charity's fundraising activity – CRA will look to the following indicia to see if there is a distinct objective other than fundraising and to assess how much of the content relates to that objective:

- Advancing the programs, services or facilities offered by the charity;
- Raising awareness of an issue;
- Providing useful knowledge to the public or the charity's stakeholders about the charity's work or an issue related to that work; and
- Being transparent and accountable for its practices by providing information about its structure, operations or performance to the public or its stakeholders.

Test B – Four Part Test – Exception

If any of the answers to the questions under Test B is "yes" all of the costs must be reported as fundraising expenses, unless the charity can demonstrate that the activity demonstrably furthers one of the charity's purposes. In such cases, the charity may be allowed to allocate a portion of the costs other than to fundraising expenditures. CRA will only consider an event to advance a charity's purposes where it is designed to prompt an action (other than giving a donation or other financial support) or a change in behaviour. The event should also reach a significant portion of the charity's stakeholders other than its current or prospective donors or show greater emphasis on helping beneficiaries rather than obtaining financial support.

Evaluation of Fundraising Activities

A range of factors will be taken into account in the course of a CRA review. One factor will be the ratio of fundraising costs to fundraising revenues.

- Fundraising revenues – amounts reported on Lines 4500 and 4630 on Form T3010
- Fundraising expenditures – amounts reported on Line 5020 on Form T3010

- Ratios of Costs to Revenues Over Fiscal Period

    - Under 35% - Unlikely to generate questions or concerns

    - 35% and Above – CRA will examine the average ratio over recent years to see if there is trend of high fundraising costs. The higher the ratio; the more likely questions and concerns

    - Above 70% - Will raise concerns and is rarely acceptable. Charity must be able to provide an explanation and rationale for this level of expenditure to show it is in compliance

However, fundraising ratios alone are not determinative – the guidelines seek to allow charities a means to gauge their performance and to provide guidance as to when CRA may seek additional information or justification for fundraising costs.

In addition to the ratio ranges, CRA will take into consideration the following factors:

- The size of the charity - which might have an impact on fundraising efficiency;

- Causes with limited appeal - which could create particular fundraising challenges; and/or

- Donor acquisition and planned giving campaigns – which could result in situations where the financial returns are only realized in later years.

The Fundraising Guidance lists a number of best practices that may be considered to decrease the risk of unacceptable fundraising:

- Prudent planning processes;

- Appropriate procurement processes;

- Good staffing processes;

- Ongoing management and supervisions of fundraising practice;

- Adequate evaluation processes;

- Use made of volunteer time and volunteered services or resources; and

- Disclosure of fundraising costs, revenues and practice (including cause-related or social marketing arrangements).

These factors are considered to be indicators only and applicability will be dependent upon a number of factors, including the size of the fundraising event.

The Fundraising Guidance also lists a number of indicators that could cause the CRA concern and potentially lead to the further review of a charity's fundraising activities:

- Sole-source fundraising contracts without proof of fair market value;
- Non-arm's length fundraising contracts without proof of fair market value;
- Fundraising initiatives or arrangements that are not well-documented;
- Fundraising merchandise purchases not at arm's length, not at fair market value, or not purchased to increase fundraising revenue;
- Activities where most of the gross revenues go to non-charitable parties;
- Commission-based fundraiser remuneration or payment of fundraisers based on amount of number of donations;
- Total resources devoted to fundraising exceeding total resources devoted to program activities; and
- Misrepresentations in fundraising solicitations or in disclosures about fundraising or financial performance.

C. What It Means - Policies and Procedures for Compliance

The Fundraising Guidance has been improved from previous drafts with consultation from the community that has contributed to the implementation of the new evaluation ratios and processes. Many of the requirements, factors and criteria in the Guidance are still complicated and subjective and will be open to interpretation by the CRA going forward.

For example, the evaluation ratios are different from those of the disbursement quota. As a result, new fundraising policies and checklists will need to be developed to take into account the Fundraising Guidance's requirements and evaluation criteria.

Greater focus will be required on the analysis of proposed fundraising costs, revenues and practices on a going forward basis. "Best practices" as identified by the CRA and outlined above should be adopted whenever possible. Prohibited fundraising conduct should be avoided and any of the indicators attracting CRA review should be avoided whenever possible. Internal evaluation of each fundraising activity should be carried out and tracked throughout each fiscal year and beyond in order to ensure overall compliance.

3. FOREIGN ACTIVITIES: REGISTERED CHARITIES OPERATING OUTSIDE CANADA

The CRA released a new proposed guidance, effective July 8, 2010, regarding Canadian registered charities carrying on activities outside of Canada (the "Foreign Activities Guidance"). This Foreign Activities Guidance updates and replaces previous policy statements issued by the CRA on this topic, and in particular Guide RC4106, *Registered Charities Operating Outside Canada*.

The Foreign Activities Guidance is relevant to all registered charities, not only those carrying on activities outside of Canada, because it provides information on what steps registered charities have to follow when using intermediaries (such as agents or contractors) to carry out charitable activities in Canada or around the world.

The Foreign Activities Guidance does not substantively change CRA's position with respect to the use of intermediaries by registered charities, but it does provides greater detail regarding CRA's expectations and requirements in this regard, and in this way, it is a useful resource for registered charities to consider when planning their activities on an ongoing basis.

A. What Requirements are Imposed on Registered Charities when working with Intermediaries?

Pursuant to the provisions of the ITA, registered charities can only use their assets in two ways:

(i) in the course of carrying out their own activities; and
(ii) on gifts to qualified donees (i.e., other registered charities and other specified entities).

The Foreign Activities Guidance indicates that a registered charity's own charitable activities are those which are directly under the registered charity's control and supervision and for which it can account for any funds expended.

The Foreign Activities Guidance provides information on what steps registered charities have to follow when using intermediaries (such as agents or contractors) to carry out their charitable activities in order to ensure that they are in compliance with the requirements of the *Income Tax Act* (Canada). In brief, the CRA requires that registered charities take all necessary measures to direct and control the use of their resources when carrying out charitable activities through an intermediary.

What registered charities cannot do, pursuant to the provisions of the ITA and the Foreign Activities Guidance, is act as conduits to funnel money to organizations that are not qualified donees. To avoid being a conduit, a registered charity must have demonstrable control over its own funds, so that the carrying out of the activity by the intermediary amounts to the charity carrying on its own activity itself.

B. How Can a Registered Charity Use an Intermediary to Carry Out Charitable Activities?

Generally speaking, an intermediary is an individual or non-qualified donee that the charity works with in order to carry out its own charitable activities. Examples include a business hired by the registered charity to deliver a particular service, a non-profit organization engaged by the registered charity to deliver specific charitable programs, or another organization with which the registered charity has pooled its resources in order to complete a project.

The most common forms of intermediaries are: (i) agents (an intermediary that agrees to carry out specific activities on a charity's behalf); (ii) joint venture participants (an organization that works with the charity to carry out a charitable activity); (iii) co-operative participants (an organization that works side by side with the charity to complete a charitable activity); and (iv) contractors (an organization or individual that the charity hires to provide goods and/or services).

Prior to engaging the intermediary, the charity must investigate its status and activities to ensure that the intermediary has the capacity to carry out the charity's activity and that there is a strong expectation that the intermediary will use the charity's resources as directed by the charity.

C. How Can a Registered Charity direct and control its resources when working with an Intermediary?

The Foreign Activities Guidance states that in order to ensure a charity retains direction and control, it must be the body that makes decisions and sets parameters on significant issues related to the activity on an ongoing basis, such as: (i) how the activity will be carried out; (ii) the activity's overall goals; (iii) the area or region where the activity is carried out; (iv) who benefits from the activity; (v) what goods and services the charity's money will buy; and (vi) when the activity will begin and end.

The charity can accept advice from the intermediary and does not have to be involved in every decision with respect to the given activity. However, it does have to retain the power to intervene in any decision. A charity is also able to delegate responsibility for day to day operational decisions to its intermediary. However, the intermediary must provide the charity with information regarding the decisions made, so that the charity can ensure that its activities continue to conform to the requirements of the ITA.

The Foreign Activities Guidance suggests that the nature and number of measures adopted by a charity to ensure that it continues to direct and control the use of its resources should relate to the nature of the activity, including the amount of resources involved, the complexity and location of the activity, the nature of the resources being transferred, any previous experience working with a particular intermediary and the capacity and experience of the intermediary.

D. What Measures Should a Registered Charity adopt to ensure it maintains direction and control over its resources when working with an Intermediary?

The Foreign Activities Guidance strongly recommends that registered charities take the following steps when working with an intermediary:

(I) Create a written agreement, and implement its terms and provisions

Written agreements are not legally required, but properly executed agreements do provide good evidence that a registered charity is exercising direction and control over its resources. However, signing an agreement is not enough to prove that a registered charity meets the appropriate test; it must still demonstrate to the satisfaction of the CRA that it has a real, ongoing active relationship with its intermediary. The CRA has indicated that if the amount of resources is relatively minor (i.e., $1000 or less) and the activity is a one-time event, forms of communication other than a formal written agreement may be sufficient. In the Foreign Activities Guidance, the CRA has provided examples of the types of terms and conditions that it expects to see in written agreements between registered charities and intermediaries.

(II) Communicate a clear, complete and detailed description of the activity to the intermediary

Before the activity begins, the Policy Guidance indicates that the charity and the intermediary should agree on a clear, complete and detailed description of the activity. The charity should be able to document is exact nature, scope and complexity. The Policy Guidance states that depending on the nature of the activity involved, the charity should be able to provide documentary evidence that demonstrates the following:

(i) what the activity involves, its purpose and the charitable benefit it provides;

(ii) who benefits from the activity, where the activity is carried on, the expected start-up and completion dates for the activity;

(iii) a comprehensive budget for the activity, including payment schedules, and a description of the relevant deliverables, milestones and performance benchmarks;

(iv) specific details on how the registered charity monitors the activity, the intermediary and the use of registered charity's resources;

(v) the mechanisms that enable the registered charity to modify the activity, including its discontinuance if the situation requires;

(vi) the nature, amount, sources and destination of income that the activity generates and any contributions that other organizations or bodies are expected to make to the activity.

(III) Monitor and supervise the activity

According to the Foreign Activities Guidance, timely and accurate reports enable registered charities to monitor and supervise the activities carried out by intermediaries. Reporting methods can take many forms, including progress reports, receipts for expenses and financial statements, informal communication via telephone or email, photographs, audit reports and on-site inspections by the charity's staff members.

(IV) Provide clear, complete and detailed instructions to the intermediary on an ongoing basis

The Foreign Activities Guidance indicates that registered charities should ensure that they engage in a process of providing any necessary additional instructions or directions to intermediaries on an ongoing basis. Such instructions should be provided by means of written communication whenever possible.

(V) Make periodic transfers of resources, based on demonstrated performance

Funds should be transferred from the registered charity to the intermediary in installments so that the registered charity can monitor the intermediary's performance.

A registered charity should retain the right to discontinue transferring funds to the intermediary and have unused funds returned if it is not satisfied with the intermediary's carrying out of an activity and/or its reporting or other obligations with respect to the registered charity.

(VI) Record all steps taken to exercise direction and control over its resources

This information should be kept as part of the registered charity's books and records in order to verify that all of the registered charity's resources have been used for its own activities.

(VII) For agency relationships, segregate funds as well as books and records

A registered charity must take steps to ensure that its own activities are kept separate from those of the intermediary. When a registered charity enters into an agency agreement, any funds transferred by the registered charity to the intermediary should be kept by the intermediary in a separate bank account. Such funds should only be used by the intermediary when authorization is given by the registered charity or certain enumerated benchmarks are met. The intermediary should also keep separate books and records for such segregated funds.

4. CORPORATE STATUTES AFFECTING CHARITIES

A. CANADA NOT-FOR-PROFIT CORPORATIONS ACT

On June 23, 2009 the Canada Not-for-profit Corporations Act ("CNCA") received Royal Assent. This Act has brought in a modern governance era for Canadian non-share capital corporations. Government discretion over incorporation and bureaucratic policy on material as well as trivial matters has been replaced by a regime more aligned to what applies to for-profit share capital corporations. This regime emphasizes members' rights rather than government rights and will enable not-for-profit corporations to operate as efficiently as their for-profit counterparts.

Corporations Canada has posted on its website proposed regulations for the CNCA in late June 2010 for consultation. These regulations are required before the CNCA can come into force because the CNCA contemplates that certain details of the statutory provisions are to be set out in the regulations, including definitions such as the definition for "soliciting corporation", rules relating to record keeping and corporate registers, rules relating to the granting of corporate names, electronic communications and documents, methods for giving notice of meetings to members, rules for absentee voting and different levels of financial review and user fees. The deadline for submissions regarding these draft regulations was October 1, 2010.[7]

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7 The Draft Regulations are available on http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs04589.html

A copy of a bulletin outlining certain salient provisions of the CNCA is attached to Appendix 1 of this paper. Once the CNCA comes into force, a period of three years will be given for corporations incorporated under Part II of the Canada Corporations Act to apply for a certificate of continuance in order to avoid dissolution. Federal not-for-profit corporations, particularly those with large membership bases, should now begin to consider the process they will follow to bring their by-laws into compliance with the CNCA.

B. BILL 65: NOT-FOR-PROFIT CORPORATIONS ACT, 2010 (ONTARIO)

On October 25, 2010, Ontario's Bill 65, An Act to Revise the Law in Respect of Not-for-Profit Corporations, 2010, received Royal Asset. It is anticipated that Bill 65 will be proclaimed in force within approximately two years. Once in force, the Not-for-Profit Corporations Act, 2010 (Ontario) ("ONCA"), will replace the Corporations Act (Ontario) which governs Ontario's not-for-profit corporations. As with the Federal CNCA, the ONCA heralds a new and modern era for Ontario's not-for-profit corporations.

The following are the salient provisions of the ONCA:

1. As with the CNCA, the ONCA will provide a procedure by which applicants can incorporate as of right;

2. The purposes must be set out in the corporation's articles. However, corporations can have all the rights powers and privileges of a natural person. If commercial purposes are included then there must be a statement to the effect that such purposes are intended only to advance one or more of the not-for-profit purposes;

3. There are two categories of "corporation". A corporation may be a public benefit corporation (under the CNCA called a "soliciting corporation") or not a public benefit corporation (like the CNCA's "non-soliciting corporation"). Charitable corporations are automatically considered public benefit corporations. A non-charitable corporation will be considered a public benefit corporation if it receives more than $10,000 in a financial year in the form of donations or gifts from persons other than its members, directors, officers or employees, or in the form of grants from the federal, provincial or municipal government or agency thereof;

4. The head office of a corporation incorporated before the ONCA will be deemed to be the registered office of the corporation. Records must be retained at the registered office or at another location in Ontario designated by the directors;

5. Directors need not be members unless the by laws otherwise provide. There must be a minimum of three directors and not more than one third of the directors of a public benefit corporation may be employees of the corporation or any of its affiliates. Staggered terms of office are permitted as are ex-officio directors;

6. There is no longer a requirement that the president be a director;

7. Conflicts of interest are dealt with by disclosure and refraining from voting – a regime similar to that of the OBCA. If the directors are all conflicted and cannot vote on a proposed material contract or transaction, the ONCA contemplates that the members can approve the matter; and

8. The ONCA gives extensive voting rights and remedies to members similar to those for shareholders of the OBCA. However, there does not appear to be any mechanism for a unanimous shareholder agreement that would otherwise remove the powers of the directors and give them to the member.

Further details of the new legislation are set out in Appendix 2 to this paper.

5. CHARITABLE GIFTS BY WILL

Introduction

Deductions in the form of tax credits for gifts to charities have increased over the years. Individual are entitled to a federal tax credit of 15.5% on the first $200 and 29% on any amount over $200 in addition to provincial tax credits. Corporations are similarly entitled to charitable deductions. Deductions not fully used in the year of the gift may be carried forward 5 years. Gifts to charities are allowed up to an annual limit of 75% of net income. There are additional limits relating to gifts made from taxable capital gains and donations of depreciable property. In the year of death, an individual may gift to charity up to 100% of net income in the year of death and this limit applies both to the year of death and to the year prior to death. Consequently, making charitable gifts through wills is an attractive estate planning tool.

Having an understanding of the rules relating to charitable gifts will assist a charity to know when and whether to issue a receipt and when not to. Gifts by will or by an estate or trust are entitled to receive receipts from the charity in certain cases. Generally, a receipt will not be issued if there is an intervening life interest until the death of the life tenant. Distributions to charity as an income or capital beneficiary in satisfaction of an interest in trust are likewise not entitled to a receipt.

It is important to understand when a charitable tax credit is available and to which taxpayer – deceased or estate or trust under will - as this will affect the ability to reduce tax on death or during the term of the trust or on the death of a life tenant. Estate planners need to ensure that the tax credit will be available when it can best be utilized.

Impact on Disbursement Quota Calculation

Prior to the Federal Budget 2010 changes to the disbursement quota regime, gifts received by a charity by way of bequest or inheritance constituted "enduring property" and provided the charity with an exemption from having to fulfill the requirement of expending 80% of the gift in the year following receipt. Prior to the new disbursement quota changes, gifts of enduring property did not affect the disbursement quota of the recipient charity until the property was expended or transferred, at which time, the expenditure or transfer was added to the disbursement calculation. Under the proposed draft legislation, the abolition of the 80% charitable expenditure rule will simplify the disbursement calculations and the classification of a gift as being "enduring property" will no longer be required to calculate the disbursement quota. Distributions to charities in satisfaction of an income or capital interest in a trust (i.e., as beneficiaries) are not entitled to a charitable receipt and are therefore not affected by the disbursement calculation.

The Rules

Subsection 118.1(5) of the Income Tax Act provides that when an individual makes a gift in his or her will, the gift is deemed to have been made by the individual immediately before death. Subsection 118.1(4) provides that a gift made in the year of death is deemed to have been made in the year immediately prior to death to the extent the charitable tax credit has not been fully claimed in year of death. This allows the donation tax credit to be claimed in the terminal tax return of the deceased individual or in the preceding year.

Non-qualifying Gifts

If the gift does not qualify as a "gift by will" the estate or testamentary trust may be entitled to a charity tax credit of up to 75% of the income of the estate or trust. In other cases, the charity may be a beneficiary of a trust such that the distribution to the charity is in satisfaction of an income or capital interest in a trust. In such circumstances, a donation tax credit will not be available to the trust.

Questions to be asked by Estate Planners

When considering the implementation of a charitable gift plan, the estate planner should ask him or herself the following:

- Is it gift by will? If so, the individual (or corporation) will be entitled to a charity tax credit in the year of death or prior year.
- Is it a gift by an estate or trust? If so, a charity tax credit will be available to the estate or trust.
- Is it a distribution in satisfaction of an income or capital interest in a trust? If so, it will not be entitled to a charitable receipt.
- Is it possible to draft the will so as to achieve the desired result of having a charity tax credit available at the time the tax liability arises?

Testamentary Gifts

There are two types of testamentary gifts that can be made to a charity; outright gifts and gifts involving trusts.

<u>A. Outright Gifts</u>

Outright gifts can take the form of legacies and bequests. A share of the residue of an estate, with no intervening life interest, is also an outright gift. Gifts over to charities in the event that the beneficiaries under the will predecease or disclaim the gifts are also categorized as outright.

The estate planner must address the central issues surrounding the making of an outright gift, including the following:

- the intention of testator;
- the identity of the charity or charities intended to receive the gift;
- the quantum of the gift;
- the timing to complete the gift;
- the form of property to be donated; and
- the conditions attached to the gift, if any.

The CRA's prior position in this regard was to require that these issues be expressly set out in the terms of the will – the trustees were given no discretion.[8] The current CRA position provides that a will can stipulate that a specific amount be gifted to charity and provide a list of charities to which donations can be made, with the trustees having a discretion to determine the amount to be given to each named charity provided that the actions taken by the trustees are reasonable and in accordance with the terms of the will, and the donation is in fact made to a charity.[9] Thus, the will can direct the trustees to donate a specific amount to a charity and appoint the trustees to have full discretion to decide which charity will receive the gift.[10]

The CRA has accepted a gift by will where the will directs a private foundation to be established following the testator's death. It is, however, uncertain whether this view could be applied to charitable organizations or public foundations established after the death of the testator.[11]

With respect to quantum, the CRA has stated that the will must expressly set out either (1) the specific amount of the gift or (2) the specific percentage of the residue of the estate.[12] Where a will provides for specified amounts to be given to a number of specified charities, but the executors are given the power to reduce the amounts, as necessary, in the event that there are insufficient funds available to make all charitable bequests after the payment of all fees and expenses in the administration of the estate, the actual amount donated by the estate

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[8] CRA Docs #9732295 (Mar 20/98); #9922805 (Sept 15/99); #9418215 (Dec 1/99); #2000-005187 (Mar 6/00); # 2000-0099815 (Apr 18/00); #0053185 (Apr 18/02)

[9] CRA Docs #9732295 (Mar 20/98); #9918215 (Dec 1/00); #9922865 (Sept 15/99); #2000-0055825 (Mar 8/01)

[10] CRA Doc #2001-0090205 (Apr 11/092); and see prior position #2000-0014355 (May 9/00)

[11] CRA Doc # 2000-0005187 (Mar 6/01); See also CRA Information Letter O/L 2001-012 (Mary 14/01); and CRA Doc# 2000-005825 (Mar 8/01)

[12] CRA Document #2000-001505 (Jan 11/0); Doc #2000-015215 (Jan 11/01)

would qualify as a gift made by the will.[13] Where a will provides that a gift is to be made to a charity within a dollar range, the deceased would be entitled to claim a tax credit for the minimum amount of the range, with the estate being entitled to a credit for donations made above the minimum amount. The CRA's reasoning for this is that donations above the minimum amount would be purely within the discretion of the trustees.[14]

The will may provide for the donation of a specific percentage of the residue of an estate to a charity. In some situations, it is acceptable for the will to provide for a formula determining the amount of the residue of the estate to be donated.[15]

The CRA generally requires that the will must expressly set out the specific amount or a percentage of the residue of the gift. In a 2004 technical interpretation, pursuant to the terms of the will, a surviving spouse selected which pieces of artwork she wished to have from a collection of artwork owned by the testator, with the remaining pieces to be donated to an art gallery within 36 months after the testator's death. This was found to be acceptable because the executor did not have any discretion on whether the painting would be donated.

In general, gifts made by a will should be completed within a reasonable period of time after death and the CRA may be requested to adjust the tax return in the event that the gift is made after the assessment of the deceased's final tax return (subject to the time limitation for reassessments).[16]

The will must specify what is to be paid from the estate. Trustees can have discretion to decide the form of property to be donated, unless the will specifies otherwise.[17] For example, if the will stipulates that a specific amount is to be gifted to a charity, without stipulating the form of the gift, the trustees may use their discretion to decide the form of property to be donated. Another example where a trustee can use his or her discretion as to the form of property to be gifted is where the will permits a gift to be made in cash or in specie. It should be noted that conditions attached to gifts are acceptable.

Fair Market Value

If a gift is made by will but the value of the property appreciates or decreases in value after the date of death, the CRA takes the position that the donation tax receipt should be based on the fair market value immediately before death.[18]

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[13] CRA Doc #2000-0014355 (May 4/00)
[14] CRA Doc #9918215 (Dec 1/99)
[15] CRA Doc #9922865 (Sept 15/99); #9918215 (Dec 1/99); #2004-00802193 (Jan 19/05)

[16] CRA Doc #2000-005187 (Mar 6/01); Doc #2000-0055825 (Mar 8/01);
And Information Letter O/L 2001-012 (May 14/01); #2000-0053185 (Apr 18/02)
[17] CRA Doc # 2000-0011755 (Jan 11/01); 2000-0015105 (Jan 11/01)
CRA Doc # 2001-0069965 (Mar 19/01)
[18] Technical Letter #9827515 (Jan. 20, 1999)

By way of summary, subsection 118.1(5) will not apply and a gift will not qualify as a gift by will in the following circumstances:

1. where the executors are given the discretion as to whether to make a gift to charity or not and the amount of the gift. This is so even if the names of the charities have been provided;

2. where the executors are given the discretion to make a charitable gift within a dollar range or a minimum amount is specified. In such a case any amount over the minimum is not considered a gift by will but rather a gift by the estate; and

3. where there is an intervening life interest and there is a right to encroach on the capital in favour of the life tenant.[19]

B. Distributions from Trusts

With respect to distributions from trusts, the CRA can characterize these distributions in one of three ways: (1) as a charitable gift made by the trust; (2) as a distribution in satisfaction of the charity's income interest in the trust; or (3) as a distribution in satisfaction of the charity's capital interest in the trust.

If the distribution constitutes a distribution in satisfaction of the charity's income interest in the trust, then the trust will be entitled to elect to deduct the amount distributed to the charity from its income in the year of distribution. However, this will not provide relief against tax liability arising from the deemed disposition of the trust's assets on the death of a life tenant of a qualifying spouse trust. That is to say, if the income includes taxable capital gains arising as a consequence of the death of the life tenant of a qualifying spouse trust, the distribution to the charity cannot be deducted from this "income".[20]

If the distribution constitutes a distribution in satisfaction of the charity's capital interest in the trust, then subsection 107(2) of the Income Tax Act will apply to allow for a rollover of the property to the charity but will not provide the trust with any relief against the tax liability arising from the deemed disposition of the trust's assets on the death of the life tenant of a qualifying spouse trust.

The question which arises is what are the criteria to delineate between a gift made to a charity by a trust and a distribution made to a charitable beneficiary of a trust? The CRA appears to have different administrative positions depending on whether it is dealing with *inter vivos* or testamentary trusts.

In Technical Interpretation 2000-0056625, the CRA differentiates between its administrative positions as they relate to alter ego trusts and testamentary trusts. In the case of testamentary trusts and in the context of a charitable income beneficiary of a trust, it is the administrative practice of the CRA to allow the trustees to choose to treat a discretionary distribution from the

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[19] *O'Brien v. MNR* 91 DTC 1349 (TCC) IT 22R Nov. 29, 1991 CRA Document 2002-0117823 May 1, 2002.

[20] See CRA, Document #9728765.

trust to a charitable beneficiary as either a gift or a distribution in satisfaction of the charity's income interest. In the case of alter ego trusts, the tax treatment depends on the proper characterization of the distribution rather than the election of the trustees. As the CRA notes, where the trust agreement empowers the trustees to make a gift and the trustees exercise this power, it would be appropriate for subsection 118.1(3) of the Income Tax Act to apply. On the other hand, where the charity is an income beneficiary and a distribution is made out of the trust's income, subsection 104(6) will be the relevant provision. As a result, it appears that the salient consideration is whether the trust instrument merely "empowers" the trustees to distribute property to a charity or if it directs that such distributions be made.[21]

With respect to donations to charities from the capital of a trust, the CRA appears to take a similar position with respect to the relevance of the existence of trustee discretion.[22] In Technical Interpretation 9811782, the CRA was asked to consider a spousal trust that gave the trustees the right to encroach on the capital during the lifetime of the spouse and provided for a gift over to a charity on the death of the spouse. The CRA concluded that the donation tax credit was not available to the deceased, but was available to the trust on the distribution of the trust property to the charity on the death of the deceased's spouse. The CRA's reasoning was that because the trustees of the spousal trust effectively had the discretion not to distribute any property to the charity (through the right to encroach on the capital during the lifetime of the spouse) the gift was being made by the trust and not the deceased

Gifts of Capital by Trusts: Power to make gifts

As noted above, if the gift is not a gift by will, consideration must be given to the factors that indicate that it may be a gift of capital by a trust.

In Document 2004-0060621E5, the CRA notes that "in circumstances where the only direction in the trust document for the making of gifts to a qualified donee is the empowerment of the trustees to make gifts at their sole discretion, the trust will be entitled to the donation tax credit." This will be discussed in more detail below, but it should be noted at this point that if the trust document directs the payment of amounts to a charity, the distribution will be viewed as a distribution to a beneficiary and not as a donation entitling the trust to a donation tax credit.

In discussing what constitutes a gift of capital by a trust it is of assistance to note when such an issue might arise. Some difficult planning problems can arise in testamentary situations where the testator wishes to defer a charitable gift until after the death of both himself and his spouse. In such cases it is not uncommon for the will to establish a qualifying testamentary spouse trust. This would allow for a deferral of the tax on the accrued gains of assets passing to the qualifying spouse trust until after the death of the second spouse to die. Typically such trusts allow the trustees to encroach on the capital of the trust for the benefit of the surviving spouse. As a result, the gift to the charity on the death of the surviving spouse is not considered to be a gift by will,[23] and the distribution to the charity on the death of the surviving spouse is seen as a distribution to

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[21] See CRA, Document #9918215 and #9728765.

[22] See CRA, Technical Interpretations 9732295, 9728765 and 9811782.

[23] See *supra* note 6.

a beneficiary. Pursuant to the provisions of subsection 107(2) of the Income Tax Act, this distribution would occur on a rollover basis and no donation tax credit would be available to offset the taxes arising on the death of the surviving spouse.

Similar issues arise in situations involving alter ego and joint partner trusts, where assets are contributed on a rollover basis, and the relevant taxes only arise in the trusts on the death of the contributor (in the case of an alter ego trust) or on the death of the last to die of the contributor and his or her spouse (in the case of a joint partner trust). As with the testamentary spouse trust scenario described above, a gift to a charity on the death of the contributor, or on the death of the last to die of the contributor and his or her spouse, will likely be seen as a distribution to a beneficiary and a corresponding donation tax credit will not be available unless the distribution can be characterized as a gift made by the trust.

So the question becomes, if it is desired to have a trust claim a donation tax credit to offset tax arising on the on the death of the life tenant of a spouse trust or alter ego trust, or on the death of the last to die of a contributor to a joint partner trust and his or her spouse, what criteria is necessary in order for the distribution to qualify as a charitable gift made by the trust. In order for a distribution from a trust or estate to a charity to qualify as a gift made by the estate or trust for the purposes of subsection 118.1(3) of the Income Tax Act (Canada), it appears, based on the CRA's comments over the years, that the following factors must be present:[24]

(a) the executors or trustees must be empowered to make gifts to charities;

(b) the executors or trustees must be exercising discretion as to whether or not to make gifts to charities;

(c) the distribution of property to the charity must be considered a "gift" for the purposes of the common law – i.e., a voluntary transfer of property without consideration;

(d) the recipient charity must not be receiving the distribution of property from the estate or trust in satisfaction of its interest in the estate or trust; and

(e) the transfer of property in question cannot be considered to be a "gift by will" for the purposes of subsection 118.1(5) of the Income Tax Act.

The following discussion provides excerpts from the CRA publications where these factors were referenced.

4. *The executors or trustees must be empowered to make gifts to charities.*

(f) Document 2003-0182905 (December 11, 2003)

> "First, the individual could, in the terms of the trust agreement, empower the trustees to make gifts to charity. If the trustees then exercise that power a tax credit may be available to the trust

[24] I wish to acknowledge the assistance of my colleague, Laura West in this section of the paper.

pursuant to subsection 118.1(3) of the Act. It is a question of fact and law whether the terms of a particular trust agreement provide such discretion to the trustees."

5. *The executors or trustees must be exercising discretion as to whether or not to make gifts to charities.*

    (g) Document 2000-0029185 (August 09, 2000)

    "Generally, it is our understanding that, unless the will provides sufficient discretion for the executors as discussed below, the Estate could not make a donation that would qualify for a tax credit for donations and gifts for the Estate. However, the estate of a deceased taxpayer is a taxpayer separate and apart from the deceased and, accordingly, could claim a donation if it is in fact the donor. As such, if the deceased's will provides sufficient discretion for the executors to decide on whether or not to make a donation the estate may be entitled to the tax credit for donations and gifts….."

    (h) Document 2000-0014355 (May 09, 2000)

    "Whether or not a gift to a registered charity will result in a donation tax credit being available to the deceased pursuant to subsection 118.1(5) or in a donation tax credit being available to the estate of the deceased pursuant to subsection 118.1(3), is a question of fact and depends upon the wording in the deceased taxpayer's will and the discretion given to the executor of the estate with respect to the making of gifts to charity…..

    If the executor has the discretion to determine whether or not gifts are to be made to charities from the estate, then the gift when made would generally be viewed as having been made by the estate."

    (i) Document 9727787 (January 30, 1998)

    "If the deceased's will had provided sufficient discretion for the executors to decide on whether or not to make a donation there could have been an argument that the estate was entitled to the donation credit….the estate of a deceased taxpayer is a taxpayer separate and distinct from the deceased, and accordingly, could only claim a donation when it is in fact the donor...."

6. *The distribution of property to the charity must be considered a "gift" for the purposes of the common law – i.e., a voluntary transfer of property without consideration.*

    (j) Document 9822955 (January 13, 1999)

"In your letter, you described a situation where a testamentary spousal trust is created and the terms of the trust provide that, on the death of the spouse-beneficiary, the entire trust fund is to be paid to one or more registered charities. The amount to be allocated to each of those charities will be left to the discretion of the trustees of the spousal trust....

With regard to the question of whether the spousal testamentary trust would be entitled to claim a charitable donation tax credit, such a determination can only be made with reference to the terms of the particular will. To qualify for the charitable donation tax credit, the donation must constitute a gift. The term "gift" is not defined in the Act and therefore assumes its common law meaning. In our view, a gift at common law is a voluntary transfer of property from a donor, who must freely dispose of his or her property to a donee who receives the property given....Any legal obligation on the donor would cause the donation to lose its status as a gift. Further, the donation must be made without conditions, from detached and disinterested generosity, out of affection, respect, charity of like impulses."

7. *The recipient charity must not be receiving the distribution of property from the estate or trust in satisfaction of its interest in the estate or trust.*

(k) See Document 2003-0182905 (December 11, 2003)

"If the charity receives property in satisfaction of its interest in the trust, the distribution of property is not a gift. However, the charity's interest in the trust may have been a gift. If the donor did not receive a tax credit when the trust was created because the charity's interest could not be valued (e.g., because of the income beneficiary's right to encroach), the donor's tax return for that year and for the following five taxation years could be amended once the gift can reasonably be valued provided the relevant taxation years are still open. If the charity receives property as a consequence of the trustee exercising discretion to distribute property to it, the distribution of property is gift."

(l) Document 9918215 (December 01, 1999)

"....in our view, it is a question of fact to be determined based on the specific wording of the will and the intentions of the trustees at the time a distribution is made to a charity, whether the payment of amounts to a registered charity by a testamentary trust represent a distribution out of income to a beneficiary of the trust, and therefore fall within the scope of subsection 104(6), or are a charitable donation made by the trust for which a tax credit under subsection 118.1(3) may be claimed by the Estate…..

"With respect to inter-vivos trust arrangements, your letter raised questions as to the application of subsections 118.1(3) and 107(2) on the distribution of capital property of the trust to discretionary capital beneficiaries. Again, we assume that the terms of the trust provide the trustees with the discretion to make charitable gifts. Based on this assumption,……this is a question of fact which depends upon the specific wording of the trust agreement and the intentions of the trustees in making the distribution to the charity. It must be determined whether the intention of the trustee was to have the trust make a distribution to the charity as a donation of capital property of the trust or in settlement of a capital interest which the charity may have in the trust."

8. *The transfer of property in question cannot be considered to be a "gift by will" for the purposes of subsection 118.1(5) of the Income Tax Act.*

(m) Document 9811782 (February 11, 1999)

"Where the donation is viewed as a gift by Will, it is our view that the trust cannot claim a tax credit at any time under subsection 118.1(3) of the Act on the trust's income tax return as the trust is not making a "gift".

Matching liability for tax with charitable donation

The foregoing discussion highlights the complexities involved in charitable gifting through wills and trusts. This complexity is increased when operating businesses are involved in the mix as not only must there be a consideration of how best to maximize the charitable donation credit, but also there is a need to consider how to avoid the potential double tax issues that can arise in such situations.

The double tax issue can arise because the general rule is that on the death of a taxpayer he or she is deemed to have disposed of all of his or her assets at fair market value immediately before death, thus giving rise to potential tax on any accrued gains, including accrued gains on the shares of an operating company, or on the shares of a holding company the assets of which include the shares of an operating company. The second level of tax arises at the corporate level when the corporation disposes of assets with accrued gains.

The following is a not uncommon scenario that further illustrates the relevant issues.[25]

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[25] The following is taken from a presentation made by Angela M. Ross of PricewaterhouseCoopers LLP and M.E. Hoffstein Fasken Martineau entitled "Charitable Donations in Estates and Trusts: The Problems with Giving".

Assume that a testator wishes to do some estate planning that involves a gift to charity. Not atypically, he is married to a second wife and has children from a prior marriage. His major asset is shares of a holding company ("Holdco") which in turns holds all of the shares of an operating company ("Opco"). He wishes to provide for his wife during her lifetime by way of a spousal trust of which she is the sole income beneficiary. The trustees may have the right to encroach on the capital of the spousal trust for her benefit during her lifetime. Following his wife's death, the testator wishes to leave some legacies for his children and the residue of his estate to charity. The unrealized gain on the Holdco shares is $50 million dollars and the unrealized gain on the Opco shares is $50 million dollars. It is anticipated that the Opco will be sold at some point following the death of the testator.

There are two possible scenarios. The first is that following the death of the testator, the shares of Holdco are rolled into the spousal trust at cost, following which Opco is sold and Holdco wound up. In this scenario, the tax would occur at the level of the Holdco (when Opco is sold) and the spousal trust (when Holdco is wound up). In this scenario, there would be no tax relief available as a result of the gift made to the charity as the charity would receive the residual gift, following the death of the spouse and the payments of the legacies, as a distribution in satisfaction of its interest in the trust as a capital beneficiary.

Because there is a right to encroach on the capital of the spouse trust during the lifetime of the spouse, there is no "gift by will" made by the testator, and thus no donation tax credit that can be applied against tax on death. Even if the will provided no right to encroach on the capital of the spouse trust for the benefit of the wife during her lifetime, such that there would be a "gift by will" made by the testator and the availability of the donation tax credit in the terminal return, the tax effectiveness of such donation tax credits would be limited. This is because the shares would roll over to the spouse trust, and as a result there would be no tax reported on the terminal return. Instead the tax liability would be at the trust level and the Holdco level.

A second scenario could be that, rather than roll the shares to the spousal trust at cost, the estate would realize a deemed disposition and report the tax arising from such deemed disposition on the terminal return. If there is no right to encroach on the capital of the spouse trust during the lifetime of the spouse, then the gift to the charity would be considered to be a "gift by will", with the result being that the donation tax credit and the exigible tax coincide on the terminal return.[26] Notwithstanding this, however, double tax will occur on the sale of Opco. The various strategies to avoid this double tax, such as one of the "bump up" strategies, might not be available because of the interests of the multiple parties and their relationships. Some strategies which have been considered in these situations include an analysis of whether the Holdco can make the charitable donation if directed to do so by the will.

In two CRA Advance Income Tax rulings,[27] complex and sophisticated plans were put forward in order to attempt to address some of these issues. The first ruling involved a transfer by a taxpayer of shares of his operating company to an alter ego trust. The terms of the trust included the requirement that the trust income be payable to the taxpayer during his lifetime. There was

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[26] If there is the right to encroach on the capital during the lifetime of the trust, the donation tax credit would be nil and therefore full tax relief would not be available.

[27] See CRA, 2008-0292121R3; 2009-0308611R3.

also an ability to make capital encroachments for his benefit. After the death of the taxpayer, specified amounts of trust property were to be distributed to trusts for various family members.

After these payments were made, but before the final distribution date, the trustees had the power to make gifts to one or more designated entities. Designated Entities was defined to mean: (i) a named public foundation; (ii) other registered Canadian charities as the trustee might add to the list of Designated Entities prior to the death of the testator and other charities; and (iii) entities incorporated under the Securities Act of Ontario that are not registered charities as the trustees may select.

On the final distribution date, any alter ego trust property remaining would be distributed to registered charities (other than the Designated Entities) selected by the trustees. It was contemplated that after the taxpayer's death, a series of transactions would be implemented to, in essence, convert the capital gain realized on the deemed disposition of the corporate shares into deemed dividends taxable as income at the trust level. Assets would be distributed from the company to the trust to fund the distributions to the family trusts and the remaining shares would be donated to the charities pursuant to the discretion of the trustees to make charitable gifts. The effect of this was to align the donation tax credit with the tax liability arising in the trust.

The second ruling provided for a similar situation.

These rulings provide a method of maximizing and matching the tax liability arising in such circumstances with the availability of donation tax credits. However, the solutions are complex and sophisticated and it is hoped that the CRA will consider amending the Income Tax Act to alleviate the need for such complex planning.[28]

6. GIFTING STRATEGIES: PERSONAL GIVING VS. CORPORATE GIVING

Strategic planning opportunities exist for donors wishing to engage in charitable giving. A donor may choose to make a personal gift, or, if the donor has a corporation, he or she may opt to maximize the charitable donation through the corporation.

As noted above, individual donors can make charitable gifts of up to 75% of net income and up to 100% in the year of death. In return for a charitable gift, individual donors receive a tax credit which they can carry forward up to five years. Corporate donors are treated similarly, however, they receive a tax deduction rather than a credit. A tax deduction will work to reduce taxable income, whereas a tax credit reduces tax payable. The tax benefit for donations made by individuals varies by province and the tax benefit for corporate donations is dependant upon the

[28] Query the risks to trustees if they are given broad powers to exercise their discretion to make charitable donations. For example, if the trustees exercise this discretion it may have the effect of reducing the value of the trust property going to the residual capital beneficiaries. Can the testator/settlor provide some guidelines to the trustees to assist them in exercising this discretion and protecting them from attack from third parties? Clearly care must be taken to carefully craft the relevant provisions of the trust or Will in such cases.

corporate tax rate that applies. Thus, donors, both individual and corporate, can achieve significant tax savings through planned giving.

Gift of Securities

Donors may choose to make their gift in cash, securities, or other forms of property. Special tax rules apply to the donation of public securities. These rules also apply to stocks, bonds, mutual funds, segregated funds, stock options and the like. Individual and corporate donors enjoy a significant tax incentive for funding major gifts – the elimination of capital gains tax. In the case of a corporate gift of public securities, the entire amount of the capital gain is credited to what is known as the capital dividend account ("CDA"). The CDA keeps track of various tax-free surpluses accumulated by a private corporation. These surpluses may be distributed as capital dividends free of tax to the Canadian resident shareholders of the corporation. The CDA also helps to ensure that tax integration is achieved (i.e., to ensure that taxes paid by an individual taxpayer are the same irrespective of whether income is earned directly by the individual or indirectly through a corporation). The account is comprised of the non-taxable portion of any capital gains, life insurance proceeds in excess of the adjusted cost base and capital dividends received from other corporations.

Use of a Holdco in Planned Giving

High net worth individuals often utilize a holding corporation ("Holdco") to retain after-tax earnings from an active business and/or proceeds from the sale of a business. Holdcos are also commonly the recipient of a transfer of investments resulting from an estate freeze. A Holdco is a vehicle for protection of excess earnings from creditors of the operating company and centralization of the investment function in a corporate group. Holdcos can also be a source of retirement income whereby assets are built up in the Holdco which are later drawn on to generate dividends during retirement. Typically, after-tax earnings of the operating company are transferred to a Holdco as a tax-free inter-corporate dividend. Additional sources of investments in a Holdco include the sale of business assets and the transfer of personal investments to avoid probate tax and/or minimize US estate tax.

Typically, a distribution of the assets of a Holdco to shareholders will attract tax liabilities. The corporate earnings of a Holdco are taxed on three levels; income earned, income distributed to shareholders and on the accrued value of the shares on the death of the shareholder vis a vis capital gains tax. Moreover, any income earned on passive assets will be subject to the top corporate tax rates. Consequently, individuals are looking for tax-effective ways to make distributions while minimizing tax consequences. If the corporation makes an in specie charitable gift of publicly traded securities with accrued gains, the tax is reduced at all three levels. There is no capital gains tax on the accrued gains and the corporation will be issues a donation tax receipt for the fair market value of the securities. The donation tax receipt issued by the recipient charity will reduce taxable income at the corporate level. In addition, the non-tax portion of the accrued capital gain will be added to the CDA which can be distributed to the shareholder on a tax-free basis. Finally, the donation and distribution both operate to reduce any capital gains realized on the death of the shareholder. Thus, the cumulative tax savings can potentially recover a significant portion of the donated amount.

Life Insurance

A donor can use some of the tax savings accrued from the charitable donation to buy a life insurance policy. Further tax savings could be achieved if the insurance policy is donated to a charity for an additional tax-free distribution. Alternatively, the life insurance proceeds could be distributed as tax-free capital dividends, thus increasing the donor's net estate and its ability to fund estate liquidity needs or maximize the net estate for distribution to the heirs.

7. GIFTS OF APPRECIATED SECURITIES – FLOW THROUGH SHARES

Flows through shares ("FTS") have become another form of gifting for donors. The shares are tax-based financing incentives to resource corporations in the oil, gas, mining, renewable energy and energy conservation sectors. These shares were introduced in the 1990s when the mining and resource industry experienced low mineral prices and resulted in a downturn in exploration. The shares were pioneered to assist such industries with raising equity.

FTS is a financing arrangement that permits an investor to invest in exploration by providing funding for the exploration and development activities of a Canadian resource corporation. Typically, resource corporations have very high upfront exploration costs with little to no revenue for the first few years. Since their revenues are quite low, these corporations have little need for the tax deductions they would incur if they were generating income. As a method of financing the exploration, the corporation can issue shares and allow the appropriate proportion of the tax deduction to "flow through" to the investor which, in turn, reduces the investor's tax cost of the shares.[29] Accordingly, the deemed cost of such shares to the investor would be nil, and could result in a significant capital gain when the shares are ultimately converted into publicly traded securities and sold once exploration is complete. Capital gains tax liabilities on the shares at the time of sale can be significant. However, if the investor does not sell the shares, but instead donates them to a registered charity, the capital gains taxes on the shares are eliminated, provided they are shares of a public corporation. Thus, the larger the accrued capital gains on the donated security, the greater the benefit will be to the donor.

For example, assume a corporation plans to incur $1,000 of exploration expenses, and a subscriber pays $1,000 and is issued FTS as consideration for the funding. The subscriber enjoys a tax saving of $460 as a result (assuming a tax rate of 46%). If the subscriber gifts the FTS to a registered charity and, assuming the value of the share is, for example, $800, the subscriber will receive a donation tax credit of $800. This will result in a further tax savings of $368. Thus the actual cost to the subscriber will have been approximately $172 and the subscriber will have made a charitable gift of $800.

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[29] Karen J. Cooper and Theresa L.M. Man, "Planned Giving for High Net Worth Clients", 2006 Ontario Tax Conference, October 16, 2006 (Toronto, Canadian Tax Foundation) at p. 7; referring to Greg Johnson, "A Practical Guide to the Flow-Through Share Rules" 2002 Petroleum Tax Journal, vol 15.

The example demonstrates how the elimination of tax on the capital gains accruing on donations of publicly traded shares to registered charities when coupled with tax incentives on FTS has generated great interest and planning opportunities. As a result there has been heightened activity by promoters marketing the attractiveness of such shares. If the FTS are acquired for the sole purpose of gifting them to a registered charity, then the donation of such shares may be an arrangement that technically qualifies as a tax shelter and thus subject to the tax shelter identification rules, even though FTS are generally exempt from the tax shelter identification rules under the ITA . If a tax shelter is not registered under the ITA then the deduction with respect to that tax shelter may be disallowed.

In CRA Income Tax Technical News No. 41 (December 23, 2009), CRA was asked the following question:

"Since both the flow through share rules and the rules to eliminate taxable capital gains from charitable donations of shares of public corporations are incentives aimed at encouraging such subscriptions and donations, what is the CRA's position with regard to whether such donations will be classified as a tax shelter (and subject to the tax shelter registration rules)?"

The response of CRA was as follows. The definition of "tax shelter" in subsection 237.1(1) of the ITA includes a "gifting arrangement" which is defined in that subsection as any arrangement under which it may reasonably be considered, having regard to statements or representations made in connection with the arrangement, that if a person were to enter into the arrangement, the person would make a gift to a qualified donee. It should be noted that the exclusion of a flow-through share in paragraph (b) of the definition of "tax shelter" is in reference to the acquisition of a property that is a flow-through share but that has not been acquired pursuant to a "gifting arrangement".

Furthermore, to increase the likelihood that CRA will allow deductions with respect to the donation of FTS to a registered charity, each FTS/donation arrangement should be registered as a tax shelter under the Act and issued an identification number by the CRA.[30] The purpose of the tax shelter registration rules is to identify the arrangements that fall within the definition of "tax shelter" for review by the CRA. The CRA has already issued identification numbers in respect of several FTS/donation arrangements, and has published advance income tax rulings on such arrangements in recent years.[31] Each of these rulings relate to FTS/donation arrangements

[30] ITA, s. 237.1(2). See also, CRA Income Tax Technical News No. 41 (December 23, 2009); Subparagraph 38(a.1)(i), subsection 248(35) through (41) and section 237.1, the Act.

[31] CRA Ruling 2009-0316961R3 – Donation of flow-through shares (2009); CRA Ruling 2007-0232271R3 – Donation of flow-through shares (2008); CRA Ruling 2007-0242361R3 – Donation of flow-through shares (2007). Regard should also be had to the following publications: CRA Conference 2008-0289451C6F – Gifting Arrangement of Flow-Through Shares = Arrangement de don d'A. Accréditives (Document is in English and French) (October 10, 2008); CRA Conference 2008-0289451C6 – Gifting Arrangement of Flow-Through Shares = Arrangement de don d'A. Accréditives (Document is in English and French) (October 10, 2008).

whereby FTS are donated to a registered charity which subsequently sells such shares to "liquidity providers".

CRA also notes that registration as a tax shelter and issuance of an identification number by CRA in relation to a particular arrangement should not be construed as the CRA approving the arrangement. It also does not mean that a subsequent audit will not result in adjustments.

As a result, investors who are interested in making donations of FTS to registered charities should ensure that promoters have registered the particular FTS/donation arrangement as a tax shelter and that an identification number has been issued and the investors must provide this identification number to CRA when claiming credits or deductions in respect of the tax shelter. Furthermore, charities should inform investors of the possible tax shelter requirements that may result from gifting FTS to avoid reputational risks if investors are ultimately denied credits/deductions for failure to obtain a tax shelter identification number.

The CRA has commented on two cases on point. In the case of *Maege v. the Queen*,[32] the Federal Court of Appeal considered whether a tax shelter existed in spite of the absence of statements or representations directly made to a taxpayer. The court affirmed the reasoning of the Tax Court of Canada in concluding that a tax shelter could exist in the absence of statements or representations made directly to the taxpayer. The case of *Baxter v. The Queen*[33] addressed a similar issue. In light of the decision in *Maege v. the Queen*, CRA was asked for its position regarding the significance of statements or representations made in the context of the definition of a tax shelter. CRA's response indicated that the decisions in these cases are consistent with its position that statements or representations do not have to be made to a particular investor in order for a particular investment to be considered a tax shelter.

One of the difficulties for charities which accept FTS is how to value such shares. Many FTS are subject to hold periods and may not retain their value during the hold period, and may not be marketable upon expiration of the hold period. Even when the shares are able to be sold within a short period of time after the charity has received them, the charity must ensure that they have determined the fair value of the shares for receipting purposes. Relevant factors to be considered in addition to the hold periods include the likely maintenance of the shares' value, and marketability of the shares after the hold period has expired. Charities should also consider whether the holding of the shares for a period of time is a prudent investment decision. As a result of all of these issues, charities should consider developing policies regarding donations of FTS.

CONCLUSION

The charitable sector in Canada has seen an increase in the requirements for transparency and accountability. The guidances, policies and tax reforms issued by the CRA have helped alleviate much of the administrative burdens faced by charities. There will likely continue to be guidances and policies in the future to assist charities, intermediaries and donors with

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[32] 2006 TCC 117, TCC, affirmed, 2007 FCA 125.

[33] 2007 FCA 172 (2007 DTC 5199); reversing 2006 DTC 2642 (TCC).

compliance matters. As can be seen from the foregoing discussion, through strategic planned giving, individuals and corporations can achieve significant tax savings in exchange for charitable donations. However, care is needed to ensure that the desired tax results are achieved.

Appendix 1

New Canada Not-For-Profit Corporations Act
Charity Law Bulletin
February 10, 2010
By: M. Elena Hoffstein, Lynne Golding and Elena Zhitomirsky

On June 23, 2009, the *Canada Not-for-Profit Corporations Act* (the "**NPCA**") received Royal Assent heralding a modern governance era for Canadian non-share capital corporations.[1] Government discretion over incorporation and bureaucratic policy on both material and trivial by-law matters has been replaced by a regime more aligned with that which applies to for-profit share capital corporations, a regime that emphasizes members' rights rather than government rights and which enables not-for-profit corporations to operate as efficiently as their for-profit counterparts.

This bulletin provides a high level summary of the key provisions of the NPCA, pointing out in some cases differences between the current *Canada Corporations Act* (the "**CCA**") and the for-profit share capital corporations act, the *Canada Business Corporations Act* (the "**CBCA**"). Further details (including statutory citations) regarding the NPCA can be obtained in our more comprehensive summary.

Continuance Under the NPCA

The NPCA is expected to come into force in 2011 or 2012. It will apply to every corporation incorporated under it in the future and to every corporation incorporated under Part II of the CCA prior to that time and continued under the NPCA. Within three years of its enforcement date, all corporations incorporated under Part II of the CCA will be required to apply for a certificate of continuance in order to avoid dissolution. The application must include an officer's certificate certifying that the members have adopted a new by-law which conforms to the requirements of the NPCA. Federal not-for-profit corporations, particularly those with large membership bases, should now begin to consider the process they will follow to bring their by-laws into compliance with the NPCA.

Terminology

The NPCA contains a number of unique terms that are relevant to its understanding, including the following:

[1] The NPCA applies to corporations considered to be not-for-profit or charitable under the Income Tax Act (Canada). Accordingly, the more appropriate nomenclature for the NPCA would have been the "Canada Non-Share Capital Corporations Act". For consistency purposes, this summary will, unless otherwise specified, refer to all such non-share capital corporations as not-for profit corporations.

"**soliciting corporation**" being a corporation which received in excess of a prescribed amount (proposed to be $10,000), during a prescribed period (proposed to be three years)[2], in the form of donations from third parties, grants or financial assistance from the federal, provincial or municipal government, or donations from other soliciting corporations; and

"**non-soliciting corporation**" being a corporation which is not a soliciting corporation.

Incorporation

Under the NPCA, corporations will be incorporated pursuant to articles of incorporation rather than letters patent. It will no longer be necessary to submit a draft form of the by-laws with the application for articles of incorporation. The corporation will no longer be required to have "objects"; however, if the corporation is a charity, it will likely continue to be desirable to include them. As well, it will no longer be necessary to list the powers of the corporation. The NPCA will allow for the incorporation of a corporation as a numbered company.

Capacity of a Corporation

A corporation incorporated under the NPCA has the capacity, rights, powers and privileges of a natural person, like corporations incorporated under the CBCA, although members may choose to limit a corporation's powers and activities in its articles.

Registered Office and Records

A corporation is required to maintain a registered office in the province specified in its articles, unless the articles are amended to specify another province. The directors may change the registered office within that province at any time.

The corporation must prepare and maintain specified corporate records. The corporation must also provide most of the corporation's members (and their representatives), creditors, and directors as well as the Director appointed under the NPCA (the "Director") with easy access to such records. The exception relates to minutes of meetings of directors and committees, to which none of the members, creditors or the Director has a right to access. The NPCA also provides for flexibility in the form of records.

Corporate Finance

A corporation may own property of any kind transferred to it, or otherwise vested in it, and would not be deemed to hold any property in trust unless that property was transferred to it expressly in trust for a specific purpose. Significantly for charities, directors are not, in that capacity, trustees of any property of the corporation, including property held in trust by the corporation.

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[2] The proposed amounts are based on a draft regulation (Section 16).

A corporation will not be permitted to distribute any of its profits, proceeds or property, directly or indirectly, to a member, director or officer of the corporation. However, an exception is made in respect of payments that are in furtherance of the corporation's activities or as otherwise permitted by the Act (i.e. the payment of a salary to an officer) or where the member is an entity and is authorized to carry out activities on behalf of the corporation.

Generally, members will not be liable for the corporation's acts or obligations, except to the extent assumed under a unanimous member agreement or to the extent that they receive money or property from the corporation upon its dissolution.

A corporation may create a lien on a person's membership interest for a debt of that member to the corporation.

Debt Obligations

The NPCA includes an extensive regime regarding debt obligations similar to that contained in the CBCA. The NPCA codifies the responsibilities of holders, brokers, purchasers, transferors and transferees of debt obligations, the methods of ensuring the validity of debt obligations, matters dealing with adverse claims, issuance of debt obligation certificates, deliveries of debt obligations and the role of agents respecting debt obligations, etc.

Directors

Unlike the CCA, the NPCA provides many particulars regarding the composition of a corporation's board of directors. Matters of frequent interest are set out below:

- Minimum number of directors: for soliciting corporations – 3, at least 2 of whom are not officers or employees of the corporation or its affiliates; for non-soliciting corporations – 1
- Staggered terms: permitted, but subject to a maximum year term limit (proposed to be 4 years) although incumbent directors are entitled to continue in office until such time as their successors are elected
- There is no provision for the inclusion of *ex officio* directors
- Directors can fill vacancies on the board so long as a quorum is in existence
- Board can increase the number of directors within the minimum and maximum if the articles so provide and appoint directors to fill such newly created positions, but no such appointment is to be longer than 1 year and the total number of appointed directors so appointed is not to exceed one-third of the number of directors elected at the immediately preceding annual meeting
- Members can remove a director before the end of his or her term by means of an ordinary resolution voted at a special meeting, with the exception of a director elected by a particular class of members, who may only be removed by an ordinary resolution at a meeting of the members of that class
- There is no requirement that a majority of the directors be Canadian residents

Directors will be allowed to receive reasonable remuneration for their services and indemnification for expenses incurred on behalf of the corporation in their capacity as directors.

Directors Meetings

The NPCA includes a number of specifics pertaining to board meetings, including permitting a number of voting conveniences currently prohibited by Industry Canada. See Schedule A.

The mechanism of a "unanimous member agreement" will become available to members under the NPCA. Through this instrument, all members of a non-soliciting corporation can agree, if they so choose, to restrict the powers of the directors to manage or supervise the activities and affairs of the corporation and take on these responsibilities themselves.

Conflicts Of Interest

As under the CBCA, directors and officers are required to disclose the nature and extent of any interest they have in any material contract or material transaction made or proposed to be made with the corporation. The obligation applies as well where the person is a director or officer of the other corporation but has no ownership interest in it.

A director required to make a disclosure is prohibited from voting to approve any such contract or transaction, unless the contract or transaction relates primarily to his or her remuneration, is for indemnity or insurance, or is with an affiliate.

Officers

Under the NPCA, directors are able to designate the officers of the corporation, appoint any person as an officer of the corporation and determine the duties and powers of the officers according to what the directors can lawfully delegate. Officers may receive reasonable remuneration for their services and indemnification for expenses incurred on behalf of the corporation in their capacity as officers.

Liability Issues

The NPCA sets out the common law duty of directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The common law due diligence defence is also set out in the NPCA. This defence allows a director to avoid personal liability arising out of his or her duties as a director where he or she has acted in accordance with that duty and exercised the care, skill, and diligence of a reasonably prudent person in comparable circumstances, including where the director relied on professional advisors.

Specific potential liabilities of directors are set out in the NPCA, including those relating to: payment or distribution to a member, director or officer contrary to the NPCA; payment of an indemnity contrary to the NPCA; and debts not exceeding six months' wages payable to an employee for services performed for the corporation.

Similar to the CCA, the NPCA permits corporations to indemnify directors and officers for losses suffered as a result of third party actions. The NPCA codifies the director's common law dissent rights, which would allow a director to avoid liability arising from matters approved by the board and which that director did not vote for, by requesting his or her dissent to be recorded in the minutes.

Committees

The NPCA permits directors to delegate their powers to a committee of directors or to a managing director; although there are certain powers that cannot be delegated, including the following powers: to change by-laws; to submit a proposal to the members for approval; to appoint an auditor; to approve annual financial statements; to fill a vacancy on the board of directors or to issue debt obligations (unless in the latter case, doing so has been specifically authorized by the board). The directors, however, remain liable for the acts and omissions of those committees to which they have delegated power. The NPCA does not mandate the creation of an audit committee, but where one is formed, it sets out certain requirements regarding its composition and conduct.

By-Laws

In a large departure from the current CCA regime, directors may, unless the articles, by-laws or unanimous member agreement otherwise provide, unilaterally make, amend, and repeal corporate by-laws except those concerning fundamental changes (see the last section of this bulletin), for which a special resolution of members will be required before they can become effective. By-laws created or amended unilaterally by the directors will require confirmation, rejection or amendment by the members at the next meeting of members. Industry Canada will no longer review and approve the by-laws or any amendments, but will keep them on file.

The only matters required to be dealt with in the by-laws are those pertaining to membership issues, including membership conditions, withdrawal rights and voting rights. It will then be the decision of the members as to what other governance matters are to be addressed in the corporation's by-laws and in what manner.

Members' Rights And Input

Members entitled to vote at an annual general meeting of the corporation are accorded the following rights regarding meetings:

- the right to requisition the directors to call a meeting for the purposes stated in the requisition; and
- the right to submit to the corporation notice of a proposal that they wish to raise at a members' meeting and to discuss such matter at the meeting. Such proposals can include nominations for election of directors and by-law amendments.

Under the new act, unless the articles otherwise provide, non-voting members will have a right to vote separately from the voting members on special resolutions that have the effect of adversely affecting their membership rights. Regardless of the terms of the articles, non-voting members will also have a right to vote as a separate class on a proposal that would have the effect of permitting memberships of another class being exchanged into memberships of their class. In addition, non-voting members have the right to vote on a resolution authorizing the sale, lease or other disposition of all or substantially all of the corporation's property and on a resolution authorizing the dissolution of the corporation.

Like the CBCA, the NPCA allows members to apply to the court for an oppression remedy where they believe their rights have been oppressed; for a derivative action remedy to enforce the rights of the corporation; or to consider any controversy respecting the election or appointment of a director or auditor. On the application of a director, a member entitled to vote, or the Director, a court can order that a meeting be called, held and conducted in a manner that the court directs.

The NPCA introduces a new provision – the faith-based defence – that would place restrictions on the extent to which derivative actions and oppression remedies may be applied to religious corporations where the matter at issue is based on a "reasonable exercise" of a "tenet of faith." Neither the term "religious corporation" nor "tenet of faith" is defined in the NPCA nor is it known what conduct will be considered to be a "reasonable exercise".

Frequently asked questions regarding members meetings and their answers are set out in Schedule A.

Financial Disclosure and Public Accountant

The form of the financial statements required to be delivered or made available to members depends on whether the corporation is a soliciting corporation or a non-soliciting corporation, and the level of its annual revenues.

Category	Reporting Obligations
Non-soliciting with gross annual revenues less than the prescribed amount (currently proposed to be $1 million)	Members can choose to appoint a public accountant or not, and can provide its financial statements to be merely reviewed or audited
Soliciting corporation with gross annual revenues less than the prescribed amount (currently proposed to be $50,000)	
Soliciting corporations with gross annual revenues that are equal to or less than the prescribed amount (currently proposed to be between $50,000 and $250,000)	Members must appoint a public accountant and can provide its financial statements to be merely reviewed or audited.
Non-soliciting corporation with gross annual revenue of the prescribed amount (currently	Members must appoint a public accountant who must conduct an audit of the corporation's

proposed to be $1 million or more)	financial statements
Soliciting corporations with gross annual revenues of the prescribed amount (currently proposed to be more than $250,000)	

A corporation can avoid the usual obligation to deliver annual financial statements or a summary thereof to the members, in respect of each member who has stated in writing that he or she does not wish to receive them or, subject to the by-laws of the corporation, by notifying its members that the documents are available at the head office of the corporation and can be requested to be sent by mail or by obtaining an exemption to the requirement from the Director. Soliciting corporations are also required to submit their financial statements to the Director.

The public accountant of the corporation is also entitled to receive notice of and to attend meetings. Public accountants must attend if asked by directors or members, and must answer questions.

Fundamental Changes

The NPCA sets out certain fundamental changes that corporations will be authorized to make and how those changes are to be authorized by the directors and members. Fundamental changes include:

- any change to its articles;
- changing or removing any rights and conditions of any class or group of members; or
- changing the manner of giving notice to members or voting by members not in attendance at a meeting of members

Any member who is entitled to vote at an annual meeting of members or a director can make a proposal for a fundamental change to the corporation.

The NPCA expressly permits corporations to amalgamate with one or more other not-for-profit corporations either pursuant to a long-form or short-form amalgamation and either vertically or horizontally and to "continue" under the laws of another jurisdiction, subject in each case to appropriate member consents and satisfying the Director that the corporation's members and creditors will not be adversely affected.

When it is not practical for a corporation to effect a fundamental change under any other provision of the NPCA, the corporation may apply to a court for an order approving an arrangement proposed by the corporation.

Schedule A:
Meeting Provisions

Query	Directors	Members
Can they act by written resolution signed by all entitled to vote?	Yes.	Yes, except with respect to the resignation or removal of a director or a public accountant, where the director or public accountant has submitted a statement giving reasons for resigning or opposing its removal.
Can they vote by proxy?	No.	Yes, if the by-laws so provide.
What is the required quorum?	Unless the articles or by-laws provide otherwise, a majority of the number or the minimum number of directors.	Unless the by-laws provide otherwise, a majority of the members entitled to vote at the meeting constitutes quorum; and so long as quorum is present at the opening of a meeting, the meeting continues to be valid even if quorum is lost part way through the meeting.
What is the required notice for meetings?	As specified in the by-laws.	Such period as specified in the regulations, currently proposed to be 21 to 60 days before the date on which the meeting is to be held.
Are teleconference meetings permitted?	Yes, subject to the by-laws, if all of the directors consent, meetings can take place by telephonic, electronic or other communication facility that permits all participants to communicate adequately during the meeting.	Same as for meetings of directors, except that no unanimous approval of the members is required and the corporation is required to make the communication facility available.
Must notice of the meeting specify the matters to be discussed?	Unless the by-laws provide otherwise, notice need not specify the business to be attended to, except with respect to the following matters: • those to be submitted to the members for approval • to fill a vacancy on the board or appoint additional directors or the auditor • to issue debt	Notice of a meeting must state the nature of all special business to be transacted in sufficient detail to permit a member to form a reasoned judgment on it and must state the text of any special resolution to be submitted to the meeting. All business other than the election of directors, appointment of the incumbent public accountant and consideration of the financial statements, is special business.

	• to approve financial statements • to adopt, amend or repeal by-laws • to set membership fees or contributions	

The NPCA permits by-laws to provide that the directors or members may make a decision by consensus, except a decision taken (a) to dispense with the appointment of a public accountant; (b) to address a matter which requires a special resolution; or (c) by a vote, if consensus cannot be reached. The by-laws that provide for consensus decision-making must define the meaning of consensus.

Appendix 2

Ontario's New Not-for-Profit Corporations Regime
November 15, 2010
By: Roxanne E. McCormick*

On October 25, 2010, Ontario's Bill 65, *An Act to revise the law in respect of not-for-profit corporations*, *2010* ("**Bill 65**") received Royal Assent. It is anticipated that the Bill will be proclaimed in force within approximately two years. Once in force, the *Not-for-Profit Corporations Act, 2010* (Ontario) as it is to be known (the "**New Ontario Act**") will replace the *Corporations Act* (Ontario) (the "**Existing Ontario Act**"), which currently regulates Ontario's not-for-profit corporations. The New Ontario Act will signal the dawn of a modern era for Ontario's not-for-profit corporations, providing a regulatory framework similar to that available to Ontario for-profit corporations under the *Business Corporations Act* (Ontario) (the "**OBCA**"). It will free Ontario's not-for-profit corporations from many of the oft-not observed restrictions contained in the Existing Ontario Act (which has not been substantially changed for the last 50 years. In these ways, the New Ontario Act follows in the footsteps of the *Canada Not-for-Profit Corporations Act* (the "**New Federal Act**"), which received Royal Assent on June 23, 2010.

This bulletin highlights a number of key features of the New Ontario Act. It is necessarily summary in nature and for precise details of the various provisions in the New Ontario Act, please contact any of the authors at the numbers/address listed at the end of this Bulletin.

Application of New OntarioAct

The New Ontario Act will apply to companies without share capital and remove them from the governance of the Existing Ontario Act. The Existing Ontario Act will continue to apply to insurers (within the meaning of the *Insurance Act* (Ontario)) and, for five years, to companies with objects of a social nature. Corporations with share capital currently governed by the Existing Ontario Act and having objects in whole or in part of a social nature have five years from the coming into force of the New Ontario Act, to apply, pursuant to a special resolution, to be continued under the New Ontario Act as a corporation without share capital or as a co-operative corporation under the *Co-operative Corporations Act* (Ontario) or as a corporation under the OBCA. If a corporation is unable to obtain the necessary quorum to pass the special resolution authorizing such a continuance, it may apply to the court for an order waiving the need for such a resolution. A corporation that is required to continue under one of these three Acts and that fails to do so will be dissolved, subject to certain saving provisions available after the fact.

It is important to note, however, that if there is a conflict between the New Ontario Act or a regulation made under it and a provision of any other Act or regulation under any other Act applying to a body corporate without share capital or with any law applicable to a charitable corportion, the other Act, regulation or law prevails.

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Incorporation and Continuance under the New Ontario Act

Like the New Federal Act, the New Ontario Act will institute a procedure by which applicants may incorporate as of right on submission of articles of incorporation and other required information and applicable fees, rather than at the discretion of the Minister of Government Services.

Corporations under the New Ontario Act must set out their purposes in their articles; however, subject to any restrictions in the regulations (not yet drafted), the purposes may be any purposes within the legislative authority of Ontario and corporations have the capacity and, subject to the New Ontario Act, the rights, powers and privileges of a natural person. If any such purposes are commercial, the articles must state that the commercial purpose is intended only to advance or support one or more of the non-profit purposes of the corporation.

Nature of Corporations

Like the New Federal Act, the New Ontario Act distinguishes between two basic categories of corporation; however, the nomenclature and precise lines of demarcation are not exactly the same. A corporation may be a "public benefit corporation" (similar to the concept of a "soliciting corporation" under the New Federal Act) or not a public benefit corporation (what the New Federal Act terms a "non-soliciting corporation"). Not surprisingly, public benefit corporations are subject to more stringent controls in a number of key areas than are non-public benefit corporations.

Again, it is no surprise that "charitable corporations" are automatically considered public benefit corporations. The definition of "charitable corporation", which spawned much discussion prior to Bill 65 at the Third Reading stage, is a corporation incorporated for "the relief of poverty, the advancement of education, the advancement of religion or other charitable purpose". Presumably, the "other charitable purpose" will be defined by common law and allows for the evolution of the concept of a charitable corporation. A non-charitable corporation (i.e., any corporation that is not a charitable corporation) will be considered a public benefit corporation if it receives more than $10,000 in a financial year in the form of donations or gifts from persons other than its members, directors, officers or employees or in the form of grants or similar financial assistance from the federal, provincial or municipal government or an agency thereof. Since the categorization of a corporation as a public benefit corporation will affect numerous matters relating to its corporate governance, for a non-charitable corporation whose status would otherwise shift during the course of a financial year from non-public benefit to public benefit, a saving provision was added just prior to the Third Reading of Bill 65 deeming it not to change its status during the financial year, but only in the next financial year as of the date of the first annual meeting in that financial year.

Registered Office

The head office of every corporation incorporated before the New Ontario Act comes into force is deemed to be the registered office of the corporation. The registered office must be in Ontario in a place specified in its articles, subject to change within the municipality or geographic township in the articles by the directors and outside of that area by special resolution. A "special resolution" is one that is submitted to a special meeting of members called for the purpose of considering it and passed by at least two-thirds of the votes cast at that meeting or consented to in writing by each member entitled to vote at the meeting.

Generally, records of the corporation required to be maintained by it must be retained at the registered office or at another location in Ontario designated by the directors. In certain circumstances, provided they remain available for inspection, including by technological means, at the registered office and the corporation provides the necessary technical assistance, the records may be kept outside of Ontario. Directors are to be given access to all mandated records, while members are entitled, on payment of a reasonable fee, to take extracts from certain records only (members are entitled free of charge to one copy of the articles and by-laws, including amendments). Members also have rights, on satisfaction of certain conditions, to access to member registers and lists of members, provided the information or list is not used otherwise than in connection with an effort to influence member voting, requisitioning a member meeting or another matter relating to the affairs of the corporation. The New Ontario Act contains provisions that allow both the corporation and members to apply to court for orders limiting or denying access to records or information required to be kept by the corporation.

Directors and Officers

One of the most welcome changes from the Existing Ontario Act is the elimination of the requirement that a specified percentage of the directors of the corporation must be members (unless the by-laws otherwise provide). However, every corporation must have a minimum of three directors and not more than one-third of the directors of a public benefit corporation may be employees of the corporation or any of its affiliates (they may, however, be officers, as long as they are not also employees). Directors are elected by ordinary resolution for a term of not more than four years, as provided in the by-laws of the corporation. Staggered terms of office for directors are permitted. In a departure from the New Federal Act, *ex officio* directors are also permitted. Except for *ex officio* directors, directors may be removed from office by ordinary resolution at a special meeting; provided that if a group or class of members is exclusively entitled to elect that director, only they may remove him or her.

The New Ontario Act permits existing directors to appoint additional directors until the close of the next annual meeting without any special authorization of the members, provided the total number so appointed does not exceed one-third of the number elected at the previous annual meeting. While consent is required to be validly elected or appointed as a director, like the OBCA, the consent can be given retroactively outside the 10 day consent period and is not required for a director who is re-elected or reappointed without any break in his or her term of office.

Unless the articles or by-laws otherwise provide, directors may meet at any place and on any notice that the by-laws require and a majority of directors constitutes a quorum for directors' meetings. As long as a quorum remains, despite any vacancy in the board, the directors may continue to exercise all of the powers of directors.

Subject to the articles or by-laws, the directors may designate offices, appoint them and specify their duties and may delegate their powers to them, subject to certain limitations. There is no longer a requirement that the President of a corporation be a director (there must, however, be a director who is appointed as chair of the board of directors). Thus the most senior executive officer of a corporation governed by the New Ontario Act need no longer be a director.

Like the OBCA, the New Ontario Act expressly sets out the standard of care by which directors and officers are to abide in exercising their powers and carrying out their duties. They must act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. A reasonable due diligence defence is included in the New Ontrio Act entitling directors to rely in good faith on certain financial information and reports of officers or employees of the corporation in certain circumstances and on reports of ecertain experts.

The New Ontario Act, like the New Federal Act, however, does not immunize directors from liability they may suffer as a result of serving as a director of a not-for-profit corporation. Corporations may provide indemnification to their directors and officers, former directors and officers and individuals acting in that or a similar capacity of another entity at the corporation's request similar to that allowed for corporations incorporated under the OBCA. The corporation may also purchase insurance for the benefit of those for whom indemnification is available, except that charitable corporations may not do so unless they also comply with the *Charities Accounting Act* or a regulation under that Act permitting that purchase or there is a court order permitting the purchase.

Conflicts of interest are dealt with by a disclosure and refraining from voting regime similar to that under the OBCA. Significantly, the New Ontario Act now expressly recognizes a conflict in circumstances where a director is a director or officer of, or has a material interest in, any other person who is party to a material contract or transaction with the corporation. If all of the directors are conflicted and unable to vote on a proposed material contract or transaction as a result of that conflict, the New Ontario Act specifically authorizes the members to approve the matter, thus recognizing a practice that many corporations with overlapping boards having transactions between them have adopted. Conflicted directors may be counted in the quorum for the directors' meetings at which the material contract or transaction is to be considered, but may not vote on that matter, subject to certain limited exceptions similar to those in the OBCA.

Subject to the articles or by-laws, directors may fix their remuneration and that of the officers and employees of the corporation and directors, officers and members may receive reasonable remuneration and expenses for any services to the corporation in another capacity.

Members' Rights

Although significant discussion focused on the extent to which members of a not-for-profit corporation without share capital should be able to exercise voting control over the activities of the corporation, the New Ontario Act gives extensive voting rights and remedies to members of not-for-profit corporations very similar to those existing for shareholders under the OBCA and for members under the New Federal Act. Unlike the New Federal Act and the OBCA, however, there is no mechanism for a unanimous shareholder agreement that would otherwise remove the powers of the directors and give them to the members.

However, any member entitled to vote at an annual meeting may submit a proposal concerning any matter he or she may wish to raise at a meeting and discuss any matter at the meeting which he or she would have been entitled to submit in a proposal. The proposal, and a statement in support thereof with the member's name and address, must be included in the notice of the meeting if the member requests, provided the member pays the costs associated therewith. Like the OBCA, the New Ontario Act contains certain exceptions from these member rights to guard against abuses in its use. Members holding at least 10% of the votes that may be cast at a meeting, or such lower percentage as may be set out in the by-laws, may requisition the calling of a meeting of members and the directors must comply with that requisition, subject to certain standard exceptions, failing which, the requisitioning members may call the meeting themselves. The New Ontario Act also includes a provision allowing a court to order that a meeting of members be held, on application by a director or a member entitled to vote.

Subject to the by-laws, the quorum for a members' meeting is a majority of those entitled to vote at the meeting, present in person or by proxy. Unless the articles otherwise provide, each member is entitled to one vote at member meetings. Voting is by show of hands, unless the by-laws otherwise require or a ballot is demanded. A corporation may also provide in its by-laws for voting by mail or by telephonic or electronic means, in addition to or instead of voting by proxy. However, voting by mail or by telephonic or electronic means may only be used if the votes may be verified as having been given by members entitled to vote and the corporation is not able to identify how each member voted.

Proxies must be made available to members concurrently with or before the giving of notice of the meeting. Generally, proxy holders have the same rights as the members appointing them to speak at the meeting, to vote by ballot and, except where they have conflicting instructions from more than one member appointing them, to vote by show of hands.

Even members not normally given voting rights have the right under the New Ontario Act to vote on certain matters affecting them differently from others and on certain other fundamental changes relating to the corporation (see discussion below under ***Fundamental Changes***).

Members are also given certain protective rights under the New Ontario Act, similar to those available to shareholders of for profit corporations under the OBCA:

(a) A member or debt obligation holder of a corporation may apply to the court for an investigation of a corporation or its affiliates and the court may make a broad variety of orders if it appears that the corporation's activities or those of its affiliates have been carried on with intent to defraud, the activities or powers of the directors have been carried on or exercised in a way that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the member or debt obligation holder, the corporation or its affiliates were formed or dissolved for a fraudulent or unlawful purpose or persons associated with formation, activities or affairs of the corporation or its affiliates have acted fraudulently or unfairly.

(b) A "complainant" may apply to court for leave to bring a derivative action on behalf of a corporation. A "complainant" includes a member, officer or director of the corporation or its affiliates, a person who ceased to be a member, officer or director within the last two years and any other person who, in the discretion of the court, is a proper person to make an application. An order in respect of the commencement of a derivative action may not be made if the court is satisfied that the corporation is a religious corporation.

(c) On compliance with stipulated procedural requirements, members of a corporation that is not a public benefit corporation are given rights of dissent and the right to be paid fair value for their membership interest if the corporation resolves to effect certain types of fundamental changes, such as amending its articles in a way that affects restrictions on its activities or powers, amalgamating, continuing or selling, leasing or exchanging all or substantially all of its assets.

(d) A complainant or creditor of the corporation may apply to court for a compliance or restraining order against the corporation, any director, officer, employee, agent, auditor, trustee, receiver, receiver-manager or liquidator of the corporation in respect of compliance/breach with the New Ontario Act, any regulations thereunder, the articles or by-laws of the corporation.

Conversely, the articles or by-laws of a corporation may provide that the directors, the members or any committee of directors or members have the power to discipline a member or to terminate their membership. If they do so provide, they must also set out the circumstances and the manner in which that power may be exercised. Any such disciplinary action or termination must be done in good faith and in a fair and reasonable manner, and the New Ontario Act provides some guidance on what kind of procedure is considered to be fair and reasonable.

Financial Matters

Subject to members passing an extraordinary resolution to have a review engagement instead of an audit or not to appoint an auditor and not to have either an audit or review engagement, at each annual meeting, members must appoint an auditor meeting the requirements under the *Public Accounting Act, 2004* and being independent of the corporation, any of its affiliates and the directors and officers of the corporation and its affiliates. The thresholds that permit corporations not to have an auditor differ for public benefit corporations and other corporations. For a public benefit corporation, a review engagement may be used if annual revenues for the financial year were more than $100,000 (or an amount yet to be prescribed by regulation) and less than $500,000 (or such prescribed amount) or it may dispense with an auditor and not have either an audit or review engagement if annual revenue is equal to or less than $100,000 (or such prescribed amount). For other corporations, the threshhold for a review engagement is annual revenue of more than $500,000 (or such prescribed amount) and for no auditor, audit or review, is annual revenue equal to or less than $500,000 (or such prescribed amount). Consideration of such an extraordinary resolution, while not considered special business at an annual meeting, requires that the resolution passes by at least 80% of the votes cast at the meeting (or by written consent of all those entitled to vote at the meeting), a much higher threshhold than the special resolution threshhold used elsewhere in the New Ontario Act.

Should a corporation choose to have an audit committee, a majority of its members must not be, employees or officers of the corporation or any of its affiliates.

Members are entitled to financial statements on an annual basis which, after approval by the directors (and prior to that, the audit committee, if any), must be placed before the members at the annual meeting.

Corporate Finance

Unless the articles or by-laws provide otherwise, directors are given powers similar to those given under the OBCA to borrow money on the credit of the corporation, to issue debt obligations, to give guarantees on behalf of the corporation and to grant security on the corporation's assets. Like the New Federal Act, the New Ontario Act recognizes that corporations own property transferred or vested in them and do not hold the property in trust unless it was transferred expressly in trust for specific purposes.

No part of the corporation's profits or its properties may be distributed to a member, director or officer except in furtherance of the corporation's activities or as otherwise permitted by the New Ontario Act. Subject to the articles and by-laws, a corporation that is not a public benefit corporation may distribute the fair value of a membership to a member on termination of that member's membership. Members are not liable, as members, for any liability of the corporation or any act or default of the corporation, except as otherwise provided. The articles may provide for a lien on the membership for a debt owing by a member which may include an unpaid amount in respect of that membership.

By-Laws

Unless the articles or by-laws otherwise provide, directors may now make, amend or repeal any by-law regulating the activities or affairs of the corporation, except in respect of the following matters which require a special resolution of members: an addition, change or removal of a provision respecting membership transfer, a change in the persons to whom property of the corporation is to be distributed on liquidation after liabilities are discharged or a change in the method of voting by members not in attendance at a meeting of members. Although by-laws, amendments or repeals passed by directors are effective immediately, they must be put to the next meeting of members for approval. If rejected or if not then put to members, they will cease to be effective.

If the directors do not pass an organizational by-law within 60 days of the date of incorporation under the New Ontario Act, the corporation is deemed to have passed the standard organizational by-laws approved by the Director under the New Ontario Act (although they can thereafter be amended or repealed and replaced in accordance with the New Ontario Act at any time). Those standard by-laws must be published in *The Ontario Gazette* and made publicly available. They have not yet been published.

Fundamental Changes

The articles of the corporation may include any provisions that may be included in the by-laws, although the by-laws must set out the conditions required for being a member of the corporation.

If in the articles, however, a special resolution of members is required to make any amendment to these provisions and a separate vote of a class or group of members (whether or not they normally have a vote) may be required. Non-voting members also have a right to vote in circumstances prescribed by the New Ontario Act which are considered to affect those members in a unique way. Such matters include exchanging or cancelling all or part of the memberships of a class, removing rights attached to a class to reduce or remove a liquidation preference or affect prejudicially voting rights, and increasing rights of classes having equal or superior rights to a particular class of members. Like articles of incorporation, once articles of amendment have been received by the Director with any other prescribed information or documents and the required fee, the Director must issue the certificate of amendment.

Members (including those who would not normally be entitled to vote) must also approve certain other fundamental changes such as amalgamations and the sale, lease or exchange of all or substantially all the property of a corporation other than in the ordinary course of its activities.

The New Ontario Act also provides for continuance of corporations from and into Ontario on satisfaction of certain conditions. A corporation is not permitted to apply for continuance outside Ontario unless the laws of the intended jurisdiction provide in effect that the property rights of the corporation continue, the corporation's liabilities continue, existing causes of action are preserved, proceedings of a civil, criminal, administrative, investigative or other nature may be continued and convictions, rulings, orders and judgments may be enforced notwithstanding the continuance.

Significantly, the New Ontario Act allows corporations obtaining the requisite member approval by special resolution to carry out arrangements, provided that the court approve the arrangement. Like the OBCA, but unlike the CBCA and the New Federal Act, it is not necessary that it be impracticable to effect the fundamental change sought by the arrangement other than by way of arrangement for the court to have jurisdiction to grant such approval. This should prove to be an effective tool for corporations proposing to implement multi-step reorganizations.

Liquidation, Winding –Up and Dissolution

The New Ontario Act contains a comprehensive regime relating to the liquidation, winding-up or dissolution of a corporation. Generally, the property of the corporation must first be applied to satisfy any debts, obligations or liabilities of the corporation. After that, if the corporation is a public benefit corporation, the remaining property must be distributed, if it is a charitable corporation, to a charitable corporation with similar purposes and if it is a non-charitable corporation, to another public benefit corporation with similar purposes, or in either case, to a government or government agency. If the corporation is not a public benefit corporation, the remaining property is to be distributed in accordance with its articles or if there is no such provision in its articles, rateably to its members according to their rights and interests in the corporation.

Certain liabilities may continue post-dissolution of the corporation (e.g. civil, criminal or other proceedings) and property that would have been available to satisfy any judgment or order had the corporation not been dissolved remains available for this purpose. As a result, despite the dissolution of a corporation, a member (including the heirs, trustees, and other legal representatives of the member) to whom any of its property has been distributed is liable to a person claiming for such liabilities to the extent of the amount actually received by that member.