PRIMER FOR DIRECTORS OF NOT-FOR-PROFIT CORPORATIONS

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PRIMER FOR DIRECTORS
OF NOT-FOR-PROFIT CORPORATIONS

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Table of Contents

PREFACE....................v

INTRODUCTION....................vii

The Reason for this Book....................vii

Terms Used in this Book....................viii

Our Approach....................x

CHAPTER 1: CORPORATIONS & DIRECTORS
What, Who, Why & How....................1

Introduction....................1

Types of Not-for-Profit Corporations....................4

Special Categories of Directors....................5

Organization Mandate....................7

Accountability....................8

Elements of Good Governance....................11

Checklist....................12

CHAPTER 2: DUTIES OF DIRECTORS....................14

Introduction....................14

The Duty of Care....................16

The Duty of Loyalty....................21

Duties Towards Members....................27

Checklist....................29

CHAPTER 3: LIABILITY OF DIRECTORS 31

Introduction 31
Liability and Contracts 32
Liability in Tort 32
Liability for Breach of Fiduciary Duty 33
Liability for Breach of Trustee Duties 33
Common Law Liabilities 36
Statutory Liabilities 36
Checklist 44

CHAPTER 4: RIGHTS AND POWERS 46

Introduction 46
Directors' Rights 46
Directors' Powers 48
Checklist 52

CHAPTER 5: COMMITTEES 53

Introduction 53
Types of Committees 54
Checklist 61

CHAPTER 6: RISK PROTECTION 63

Introduction 63
Due Diligence 64
Indemnification 68
Insurance 71
Statutory Protection 73
Other Means of Reducing Liability Exposure 74
Checklist 76

CHAPTER 7: TAXATION 78

Introduction 78
Not-for-Profit Corporations 78
Charities 79
The Regulation of Charities 82
The Treatment of Gifts to Registered Charities and Qualified Donees 84
Corporate Structures 87
Checklist 90

CHAPTER 8: DIRECTOR DEVELOPMENT 91

Introduction 91
Tools 91
Checklist 94

ENDNOTES 95

Preface

Ideally, any board of directors should be made up of individuals who bring a wide array of skills and expertise to the task of governing a not-for-profit corporation. So it is perhaps fitting that in creating this publication, we have enjoyed the luxury of drawing on an exceptionally broad range of talents and experience.

The Primer for Directors of Not-for-Profit Corporations was commissioned from the Canadian Centre for Philanthropy as part of Industry Canada's consultation work on reforming the *Canada Corporations Act*. The project benefited from the input of numerous Industry Canada staff working under the direction of first Lee Gill, then Gilles Gauthier. Eva Fried, Nicolas Lavoie and Veronica Wessels all provided assistance and feedback, helping to ensure the text was as comprehensive, accessible and accurate as possible.

Individual contributors are identified at the beginning of each chapter. These credits however, may not convey the collaborative effort that went into many chapters. Our collective aim was to produce the most user-friendly and comprehensible text we could. To do so, inevitably some material that was conceived as part of one chapter found its way elsewhere. It is a mark of the professionalism and commitment to this project of the contributors that they all readily agreed to this, without insisting that these changes be individually acknowledged.

The finished text before you would not have been possible without the participation of Norah McClintock and David Stevens. Norah provided her keen eye to ensure the text never got bogged down in legalese, and David his astute insight so that our desire to use plain language never compromised the legal integrity of the publication. As well, Paul Martel added essential information throughout the text on treatment of not-for-profit corporations and their directors under Québec Civil Law. The striking design of the book was the work of Wioletta Wesolowski.

Finally, I would like to acknowledge the dedication of Peter Broder, my colleague at the Centre for Philanthropy and the co-ordinating editor of this volume, as well as the work of Michael Anderson and Robert MacKenzie of the Canadian Association of Society Executives, and the Executive of the Canadian Bar Association Charity and Not-for-Profit Law Section, for their input and help in winning endorsement of the publication from their respective organizations.

– Gordon Floyd
Vice President, Public Affairs
The Canadian Centre for Philanthropy
June 2002

Introduction

THE REASON FOR THIS BOOK

Directors of not-for-profit corporations are, like the organizations they serve, a diverse lot. Perhaps the two characteristics they are all most likely to share are that they are well-intentioned and time-pressed. This book was created with both these factors in mind. We have attempted to prepare a text that will help directors do a good job, as well as protect themselves from potential claims arising from their actions or decisions. We have also attempted to do so in a friendly fashion that does not require prolonged study, but highlights the essentials of what you need to know.

Questions and checklists are included in each chapter to assist readers in addressing the issues raised in the text.

If successful, this book will:

- provide directors of not-for-profit corporations with guidance that both alerts them to their basic legal rights and obligations and provides them with some simple tools to help them exercise those rights and meet those obligations;
- provide prospective directors with a good understanding of their potential responsibility should they agree to serve on the governing body of a not-for-profit corporation, and advice on what to ask in order to make an informed decision on whether or not to take on that responsibility;
- provide staff and volunteers working with boards with an outline of the role of directors in a not-for-profit corporation and a ready tool to share with the members of their governing bodies and colleagues to ensure a common understanding of who does what, how, and why.

Throughout this book, we have sought:

- to keep the language as simple and untechnical as possible;
- to organize the information in an accessible way and in small, easily digestible sections;
- to keep the text concise; and,
- to do all of the above without compromising the integrity of the information.

This book focuses on incorporated not-for-profits. This includes, but is not limited to, entities such as trade and community associations, sports clubs, health and social service agencies, environmental organizations, arts groups, religious congregations, international development organizations, and human rights and civil liberties groups. It excludes, however, the countless informal groups or associations, trusts, cooperatives and other entities that are constituted outside of either federal or provincial not-for-profit corporation statutes.

Regardless of the activities of the corporation that they serve, directors of incorporated organizations all share a common requirement to supervise the management of their corporation. Additionally, they face other obligations based on the scope and type of activities their corporation undertakes, and the statutory and common law obligations arising from that activity.

TERMS USED IN THIS BOOK

Definitions

Different terms can mean different things to different people. For the sake of clarity, this primer uses the following terms and definitions:

- "Not-for-profit corporation" refers to entities incorporated under either federal or provincial not-for-profit legislation. In some cases these corporations are charities, in others not. Section 149(1)(l) of the federal *Income Tax Act* sets out a definition of "non-profit organizations", however it excludes [registered] charities, which are defined in a separate section. To avoid confusion, we generally do not use the term "non-profit organization". The term "not-for-profit" should be understood as applying to the corporate, rather than tax, status of the organization.

  We address primarily corporations established under the not-for-profit corporation statutes of the federal and provincial governments. Many other organizations, with a not-for-profit aspect, have been created under Special Acts, Private Acts or other legislation. While some of the principles and advice set out in this book may apply to such organizations, their governance is also regulated by the statutes under which they were created. Corporations incorporated under these statutes are outside the scope of the present text.
- "Charity" refers to **either** entities that have qualified for charitable registration under the *Income Tax Act* or entities whose objects would cause the courts to treat them as charities as a matter of law. Although registration of an entity by the Canada Customs and Revenue Agency determines whether it is eligible to issue tax receipts for donations, it is still possible for entities to be "charities" for other purposes even where they are not registered. If the courts determine that, given their purposes and activities, entities are charities, then their operations may be subject to provincial statutes regulating

charities and to common law rules dealing with charities.

- "Letters patent" refers to the document(s) setting out the corporate objects or purposes, which are filed with the government of the jurisdiction in which the corporation is established.
- "Organization" is a non-legal term; generally it is used to refer to an association of persons who have come together to pursue some common purpose(s). An organization may be structured legally as a corporation, a trust, a cooperative or other legal entity, or as an unincorporated association. As this book is intended for directors of corporations, unless otherwise specified, the term organization when used in this text should be understood as referring to incorporated organizations.
- "Bylaws" refers to the fundamental rules of governance of the corporation. In some jurisdictions, it is mandatory to file these with the government, in others it is not.
- "Board of directors" or "board" refers to the governing body of the corporation. Some institutions or organizations may use different terms or titles to identify those overseeing the corporation's management. However, "board of directors" is the most widely recognized and accepted term.
- "Director" refers to a member of a board of directors. The term "director" should be understood as referring to any duly elected or appointed member of the board. Most corporations statutes contemplate the possibility of *ex officio* directors and honourary directors. Some corporations include in their governance structure provisions that restrict the capacity or limit the powers, such as voting rights, of particular individuals affiliated with their board. As such individuals remain potentially subject to liability they are not distinguished from other "directors" in the text.
- "Chair" refers to a person presiding over the board or a committee.
- "Executive director" refers to the individual presiding over the day-to-day operations of a corporation.
- "Member" refers to a person with voting rights in the corporation.
- "Stakeholders" refers to members, and other constituencies of the corporation. These could include (but are not limited to): donors, staff, volunteers, alumni and clients. Again, depending on the practice of your corporation, you may be familiar with some of these functions by other terms.

Legal concepts

Readers will find it helpful to be aware of several legal concepts found throughout this book.

- "Statute" or "statutory law" is the general term for legislation and regulations, either federal or provincial, that govern conduct;
- "Common law" is the term for the findings of courts that govern conduct beyond the requirements of statute. Because common law is determined by the collective decisions of judges, it is constantly changing and evolving.
- "Case law" is the term for the findings of courts concerning a particular legal point, or more generally (and in contrast to statutory law) the entire body of judicial findings.
- "Joint and several liability" is the term describing two distinct ways that liability (and thus responsi-

bility to pay damages) may apply. It means that directors are liable both together with one or more of the other directors, and individually, to pay damages. Where this type of liability applies, a party winning an action may pursue any, some or all the directors to satisfy the judgement.

Unless otherwise specified, when we state a rule in this book, we are referring to the federal not-for-profit corporations statute, the *Canada Corporations Act*, and/or the common law that applies to corporations incorporated under this Act. Each province has its own not-for-profit corporations statutes, and although in general these statutes are very similar, there are important differences. Consequently, it is often impossible to state categorically a rule that applies across all jurisdictions.

OUR APPROACH

Legal Requirements

Some of this book deals with what directors must do, much of it concerns what directors ought to do, and we also – occasionally – touch on what directors may do. Case law concerning not-for-profit law is relatively rare. While, for instance, there are numerous judgements dealing with conflict of interest in the context of for-profit directors, few rulings are available with respect to the same issue in the not-for-profit context. This results in a large grey area where the line between what the director must do, and what he or she may be permitted to do is blurred. So we cannot tell you, definitively, the legal standard that applies when the director of a charitable not-for-profit deals with the corporation's assets. Where the law is made clear – either through statute or through court decisions – we have attempted to set this out.

Good corporate practice

A recent report of the Institute on Governance suggests good governance is about achieving desired results in a way consistent with democratic values and social justice. It identifies the elements of good governance as:

> ...*Vision* (envisioning the future), *Direction* (setting goals and providing a general 'road map'), *Resources* (securing resources necessary to achieve the goals or reach the direction), *Monitoring* (periodically ensuring that the organizational vehicle is well-maintained and progressing, within legal limits, toward its destination), and *Accountability* (ensuring efficient use of resources; reporting progress and detours to stakeholders).[1]

This process obviously goes well beyond meeting legal requirements. How any corporation attains these elements will turn on the characteristics of the corporation and its mandate. However, it can be said that good corporate practice will be impossible without engagement, competent decision making and ongoing evaluation.

In legal proceedings, adherence to good governance practice will not necessarily provide a complete defence. Where, however, a corporation or director can point to having followed an established practice in keeping with good governance, or to have chosen a course in an effort to achieve good governance, this often provides a highly persuasive argument in the corporation or director's favour.

Stewardship

Not-for-profit corporations can qualify for special tax status, and registered charities enjoy an even more generous tax treatment. This means that the public often sees itself as having an interest in how these corporations operate. Concerns can include a not-for-profit corporation unfairly competing with a for-profit entity, or a charity's misuse of donations it receives. These issues are, to some extent, addressed through the legal and regulatory schemes that apply. However, boards and directors also need to be mindful that these considerations give their corporation a public face it otherwise wouldn't have.

Many not-for-profit corporations – and, in particular, charities – enjoy high credibility with the public.[2] Indeed, this credibility is one of the key strengths of the sector. Essential to maintaining, and building on, such public trust is a corporation's commitment to transparency.

Corporate failures are perhaps the situation in which the impact on public trust of board decisions is most apparent – we can all recite the high profile cases that have resulted in adverse publicity in recent years. More openness would not have solved the underlying problems in many of these cases, but lack of disclosure almost invariably magnified the harm done to the corporation.

Few not-for-profits are sustainable over the long term if they don't enjoy the support of at least a segment of the public. Leaving aside legal requirements, there is a very practical reason for not-for-profit directors to act prudently and with all due care, and for corporations to commit to being as open as possible about their operations. More often than not, a corporation's long term health will turn on its effectiveness in stewarding public trust.

Conclusion

There is no downside to any director always complying with the intent of the law when the letter of the law is unclear, acting in accordance with good governance practice, or being mindful of how a particular action or decision would be seen by the public; indeed, it is a necessity if not-for-profit corporations are to meet the growing demands on them for integrity, accountability and transparency.

1

Corporations & Directors
What, Who, Why & How

Wayne Amundson*
President, Association Xpertise Inc.

INTRODUCTION

What is a not-for-profit corporation?

Not-for-profit corporations (also called "non-share capital corporations") are different from for-profit corporations (also called "business corporations") in three fundamental ways:

- The not-for-profit corporation is composed of members, whereas the for-profit corporation is owned by shareholders.[1]
- The members of a not-for-profit corporation cannot receive any financial (or pecuniary) gain[2] during the life of the corporation,[3] whereas a for-profit corporation may distribute profits to its shareholders in the form of dividends.
- The powers of a not-for-profit corporation are limited to what is written into its objects (purposes), whereas, typically, the for-profit corporation has no such limits.[4]

The process of incorporation is also usually different for not-for-profit corporations, although this varies from jurisdiction to jurisdiction. Incorporating a for-profit entity is a routine matter of submitting the correct forms and payments. Saskatchewan provides for a similar process with respect to not-for-profit corporations. Incorporating a not-for-profit entity at the federal level and in most other jurisdictions, however, requires government review and approval. For instance, not-for-profit entities incorporating federally under the *Canada Corporations Act* must apply to the federal Minister of Industry to issue letters patent to the corporation.[5] The proposed bylaws of the corporation must accompany the application.

In various jurisdictions, additional approvals are required, or conditions must be met, for the incorporation of certain types of not-for-profit organizations and for those with certain specific words in their name.

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EXAMPLE

A not-for-profit corporation that is an accreditation body, or sets industry standards, may require additional approvals.

EXAMPLE

A not-for-profit corporation that wants to use the term 'Canadian' must receive federal approval, and a corporation that wants to describe itself as an 'institute' or 'academy' usually has to obtain approval for the appropriate provincial education ministry.

A not-for-profit entity can incorporate either federally or provincially, depending on the scope of its stated purpose and proposed activities. Each jurisdiction has its own legislation for the incorporation of not-for-profit organizations, and its own approval process.

Advantages of incorporation

There are many advantages to incorporation. These include:

- A not-for-profit corporation has a legal status separate and distinct from its members. Members may come and go, but the corporation continues until it is dissolved or wound up.
- The not-for-profit corporation can enter into contracts, buy and sell property, etc.
- Individual members of a corporation are generally shielded from liability (see Chapters 2 and 3 for more on this).
- The formal corporate structure facilitates ongoing operations and decision-making.
- There may be increased credibility with the government, funders, and the public.
- The not-for-profit corporation has an enhanced ability, through its governing documents, to address membership status issues (e.g., removal for unpaid dues or death, and expulsion for disciplinary reasons).

Disadvantages of incorporation

There are some disadvantages to incorporation. The most commonly encountered is the paperwork and regulation entailed. This includes:

- Most jurisdictions require an annual corporate filing related to the location of the head office as well as director information.
- Some not-for-profit entities (excluding registered charities and smaller not-profit organizations) must file an annual information return with the Canada Customs and Revenue Agency.
- Incorporated not-for-profits (except registered charities) must file an annual corporate income tax return.
- Federal corporations incorporated under the *Canada Corporations Act* must get ministerial approval to change certain bylaws.[6]

Other disadvantages include:

- There are some constraints placed on the type of activity that the group or entity may engage in.
- There is a need to devote time and resources to maintaining corporate structure that would otherwise go to carrying out the desired purposes or activities of the organization.

The not-for-profit board of directors

The not-for-profit corporation is governed by a board of directors. The size of the board is defined in the bylaws of the corporation (within parameters established by each jurisdiction). While the board, as a whole, has a great deal of authority and power, the individual director, when acting alone, has almost no power. The letters patent or articles of incorporation and the bylaws establish certain elements of the corporate governance structure.

Within this basic corporate structure, however, the board is typically responsible to appoint (whether directly or indirectly) board committees, officers, employees[7] and agents of the corporation to carry out day-to-day activities. In some cases, it may fall to the corporation's membership to elect particular officers, such as the president. A director will be entitled to exercise any authority associated with an office or position to which he or she is elected or appointed.

EXAMPLE

A director selected as chair of a standing committee will enjoy the rights and privileges accorded to that position.

EXAMPLE

A director serving as a member of a special committee mandated to take a particular action on behalf of the corporation will be entitled to participate in, and vote on, deliberations considering the matter.

For-profit and not-for-profit directors share a legal responsibility to act in the best interests of the corporation. However, the stakeholders in not-for-profit corporations do not share the pecuniary interest that binds together those involved with a for-profit corporation. Having volunteer board members, and often volunteers carrying out the corporation's operations, means the dynamics of governing a not-for-profit corporation differ markedly from those of a for-profit entity. In some jurisdictions thought has been given to enacting statutes that would empower not-for-profit directors to consider stakeholders or community interests in their decision-making; however, this approach has generally been rejected.

In for-profit corporations it is assumed that those with an interest in the entity can and will be satisfied with economic compensation – either through distribution of income over time or through purchase of their share(s). No such straightforward mechanism exists in not-for-profit corporations. Not-for-profit corporations pursue purposes that are less tangible and therefore hard to quantify. This makes it much more difficult to measure the performance of the corporation and of the directors. Recognizing this, not-for-profit directors should always try to be closely attuned to the views and interests of the members of their corporation and other stakeholders.

Failure to do so is apt to result in one or both of two outcomes: either the members of the corporation will lose their commitment to the corporation and/or different factions promoting their own agendas will develop within the corporation. When this happens, the smooth operation of the organization is hampered, or in extreme circumstances, the existence of the corporation is at risk.

TYPES OF NOT-FOR-PROFIT CORPORATIONS

Most provinces, and most U.S. jurisdictions, classify not-for-profit entities by type for purposes of incorporation. There is, however, no classification of not-for-profit entities within the *Canada Corporations Act.*

Some provinces use a two-category system. While the dividing point may be similar in these provinces, the terminology and approach vary. In Saskatchewan, the *Not-for-profit Corporations Act, 1995* uses a two-part classification scheme: charitable organizations and membership organizations. In this system, all organizations that do not qualify as charities are categorized as membership organizations. Organizations can qualify as charitable either through registration with the Canada Customs and Revenue Agency or by meeting other criteria set out in the Act.

In Ontario, although there is no distinction in corporations law, not-for-profit corporations can be either charitable or non-charitable under the *Charities Accounting Act*.[8] Charitable corporations are subject to the jurisdiction of Ontario's Office of the Public Guardian and Trustee. The *Charities Accounting Act* covers "[a]ny corporation incorporated for a religious, educational, charitable or public purpose".[9]

In Québec, no distinction is made between the types of not-for-profit corporations incorporated under Part III of the *Companies Act*, and there is no equivalent of the Ontario *Charities Accounting Act* to distinguish between charitable and non-charitable corporations. However, corporations that want to solicit public donations are obliged to include certain restrictions in their letters patent.

The most common classification system in the U.S. contains three categories: mutual benefit organizations (organizations which primarily serve the interests of their members); public benefit organizations (which includes charities that are not religious organizations); and, religious organizations.

For governance purposes, it is most useful to distinguish between two principal categories of organizations.

- **Public benefit not-for-profit corporations** carry on activities that are primarily for the benefit of the public. Their revenue sources may include public and corporate donations, government grants, contract funding, and fee-for-service programs or activities. A public benefit not-for profit corporation may, but will not necessarily, be registered under the *Income Tax Act*. These organizations are at times referred to as 'charities', regardless of whether or not they are registered with the Canada Customs and Revenue Agency, and regardless of whether they meet the common law requirement that they be exclusively charitable (i.e., not engage in non-charitable work).

- **Mutual benefit not-for-profit corporations** carry on activities that are primarily for the benefit of their members. They are typically supported by their members through fees and fee-for-service programs or activities, but may also receive other revenues such as government project funding. Examples of mutual benefit corporations are trade associations, professional societies, golf clubs, social clubs, etc.

Directors of public benefit organizations generally must take into account the interests of a broader range of stakeholders in their decision making than directors of mutual benefit organizations.

All not-for-profit corporations have members.

With many mutual benefit not-for-profit corporations, membership criteria can be defined through a clear common interest, often related to service provision. With public benefit corporations, the common interest may be vaguer or very broadly stated. It follows from this that in public benefit organizations it will often be subject to debate who should be eligible for membership and whether there should be different categories of membership. In some public benefit organizations, membership is limited to a relatively small number of people – e.g., currently serving directors. Where the membership base is small, eligibility of non-members to serve as directors may be an important issue for public benefit corporations, and have a significant impact on the organization's ability to renew itself.

SPECIAL CATEGORIES OF DIRECTORS

The letters patent (articles of incorporation) or the bylaws of a not-for-profit corporation may provide for some special categories of directors. The most common are "*ex officio*", "honourary", and "public" directors.

Ex officio directors

Ex officio board members are defined in most basic procedural texts, such as *Robert's Rules of Order.* [10] They are individuals who qualify as board members because they hold an office, such as the presidency of the organization or of another – usually affiliated or related – group or organization. They may also qualify because they hold a certain public office.

An *ex officio* member of the board generally has the same rights as other directors, but may or may not have the right to vote. This should be specified in the governing documents of the corporation. It is not uncommon for a not-for-profit corporation's bylaws to state that the executive director serves as an *ex officio* board member, typically with no right to vote. This ensures the executive director has input into board decisions. Since he or she does not have a vote, this prevents a situation where the executive director is charged with implementing a decision he or she voted against at the board level.

Where the director may be considered to be acting as a trustee, such as in a registered charity or public benefit corporation, an executive director serving as an *ex officio* board member may be subject to challenge. This is because, under trust law (and under statutory law in Ontario), he or she may be obligated to serve without pay. A salaried executive director could be seen as being paid when performing his or her role as an *ex officio* board member. The law is unclear on this point, so – particularly in Ontario – public benefit corporations should avoid the practice of designating executive directors (or other paid staff) as *ex officio* board members. Alternative means for assuring executive director participation in board meetings should be sought.[11]

Regardless of whether or not they have voting rights, *ex officio* board members have the same legal duties and responsibilities as regular directors.[12] Where an *ex officio* director does not have a vote, he or she takes on liability without the opportunity to oppose a board decision or register a dissent. In these circumstances, where possible, provision should be made to provide such a director with indemnity and/or insurance protection. (See chapter 6 for a detailed discussion of indemnification and insurance.) As well, it should be noted that except where a conflict of interest arises, the *ex officio* director will be entitled to be present during any in camera discussions of the board.

Generally, the bylaws should also specify that the *ex officio* director serves as long as, and only as long as, the individual occupies the office in question.

EXAMPLE

A not-for-profit corporation wishes to ensure representation from a related organization on its board, so it provides for *ex officio* membership of that organization's president on its board in its governing documents. That president will sit as a full member of the board, and will be obligated to act in the best interest of the not-for-profit corporation. He or she will be fully liable for any board decision, unless he or she has registered a dissent or withdrawn from the decision based on a conflict of interest.

EXAMPLE

A not-for-profit corporation appoints its executive director as an *ex officio* member of the board. The bylaws provide that he or she may participate in board discussions, but is not entitled to vote. He or she will be fully liable for any board decision, and the board will be unable to exclude him or her from in camera board deliberations except where a conflict of interest arises.

Honourary Directors or Officers

Where the not-for-profit corporation makes a practice of naming honourary directors or officers, its governing documents should make provision for these positions, including their method of appointment. As with *ex officio* directors, the not-for-profit corporation's governing documents should specifiy whether honourary directors enjoy voting rights. If they do not have voting rights, honourary directors may attend meetings and take part in discussions, but may not make motions or vote.

Although commonplace, the practice of naming honourary directors or officers needs to be approached with caution. This is not to dispute the need to recognize long or distinguished service, or the value of enlisting a prominent individual in the organization as an avenue for using their name for promotional or fundraising purposes. However, by deeming such individuals as honourary directors or officers, there is a risk that they will be held liable for board decisions in which they do not fully participate. As with *ex officio* directors, the inability of such individuals to vote may not preclude them being held liable, and may preclude their being excluded from in camera proceedings.

There is little case law dealing with this issue, so it cannot be said with certainty when, or if, a person serving in such a capacity would be liable.
An alternative is to find another title or way of designating the individual that will make it apparent to third parties that he or she is not, or is no longer, an active decision maker within the organization. An individual may, for instance, be called an honourary advisor or patron.

Public Directors

Some not-for-profit corporations are required to have one or more board members appointed to represent the public. This is common in professional societies that have a role in protecting the public interest as well as the interests of their members. These directors are not members of the organization. However, they have all the rights and responsibilities of regular directors, except that they are not required to fulfill any membership obligations, such as payment of dues.

ORGANIZATION MANDATE

Knowing the mandate

To be effective in their role, directors and prospective directors must know and understand why the organization exists and whom it serves. It is equally important for the board of directors to periodically re-visit this mandate to determine its ongoing relevance and the organization's commitment to it.

Although there is much a well-governed organization can do to help a new board member become familiar with the organization and its mandate, inevitably most of the onus is on the member himself or herself to get up-to-speed. New directors should recognize that they may not get much direction beyond the opportunity to review the corporation's governing documents – and that those may or may not reflect the not-for-profit corporation's current operations – and determine how the gaps in their knowledge can best be filled. Investing time outside of a board meeting to talk to staff, other board members or former board members, can both increase the new member's effectiveness and mean board meeting time is used more efficiently. (For more on director development and orientation, see to Chapter 8.)

The Drucker Foundation's *Self-Assessment Tool* identifies five key questions that can assist not-for-profit directors in sizing up their organization:

What is our mission?
Who is our customer?
What does the customer value?
What are our results?
What is our plan?

The first three questions address the board's need to understand and re-visit its mandate. Question four looks at the organization's effectiveness in delivering on its mandate. Question five turns the board's attention to developing a plan to better deliver on the mandate.

It is also important for directors and prospective directors to understand the corporation's mandate so that they can determine whether their motivation for serving on the board is compatible with it.

In addition, the purpose of the organization, as articulated in the mission and vision, will determine why the corporation enjoys not-for profit status, why members join the organization, and why the public and other funders support the organization financially.

Corporate governance documents

In *The Guide to Better Meetings for Directors of Non-Profit Organizations*, Eli Mina describes three sets of governing documents that provide the framework for how not-for-profit entities operate:

- Laws of the land: The statute under which your organization is incorporated…
- Bylaws (or Constitution and Bylaws)…
- Meeting Procedures or Book on Rules of Order…[13]

The incorporation statute takes precedence. Where it is silent or provides for alternatives, the bylaws apply. Where both the statute and bylaws are silent, the book on rules of order applies, if the corporation's bylaws identify such a document. *Robert's Rules of Order* is typically used as the default authority where the bylaws do not specify another document. In Québec, *Procédure des assembleés deliberantes*, by Victor Morin, is the commonly used reference.

Two additional governance documents often exist in not-for-profit corporations. In some organizations, the bylaws or organizational practice may provide for 'codes' or 'regulations' spelling out practices for members . The process for amending such documents will vary from organization to organization and may entail input and decision making by members, the board and/or staff. Also in many organizations, specific decisions of the board are compiled in a 'governance' or 'policy' manual. This sets out appropriate practice without referring to discrete matters in every instance. The order of precedence, in both cases, would be after bylaws.

Not infrequently, organizations will act in a way that is at odds with their governing documents – with the consequent implications for liability. A statutory and bylaws review (also referred to as a compliance audit) can be invaluable in ensuring that responsibilities and requirements are being met. A key issue for many not-for-profit corporations is maintaining institutional memory. High turnover among board members and staff can mean that an organization revisits a matter that has already been decided, or acts inconsistently over time. Revisiting a matter usually entails wasted effort, and acting inconsistently over time is apt to alienate clients or other stakeholders. Any steps that can be taken to simplify or facilitate tracking of governance practice or decisions are worthwhile.

ACCOUNTABILITY

All not-for profit directors are potentially accountable to someone or some entity, often to multiple parties. This accountability can take many forms: annual general meetings where members can vote to replace directors they have lost confidence in or make changes to governance documents that affect the board; administrative or judicial penalties imposed owing to regulatory non-compliance; reporting requirements to funders; and, court actions mounted by dissatisfied stakeholders. While directors often focus on their legal liabilities, they also need to be mindful of their obligations to stakeholders who might not have or take legal recourse. Very infrequently legal duties will be at cross purposes with stakeholder interest, and in these rare instances, legal responsibility must take precedence. In other cases, the most skillful directors will recognize and accommodate stakeholder needs whenever possible, and thus ensure the long term health of their organization.

The accountability of directors of public benefit not-for-profit corporations is similar to that of mutual benefit directors. Typically, directors of public benefit corporations will have more constituencies to take into account than their mutual benefit counterparts. A stakeholder map can be a useful tool to help directors track their accountability when there are multiple constituencies involved with the organization.

As well, it should be noted that public benefit corporations frequently have to meet higher regulatory requirements, either through the Canada Customs and Revenue Agency or provincial legislation. In some instances, these regulatory requirements effectively replace the role of the beneficiaries in ensuring that public benefit organizations act appropriately; however, in other cases, the beneficiaries also have recourse to the courts to enforce their interest.

NOTE REGARDING JURISDICTION

Incorporation of an entity, either federally or provincially, does not automatically give that jurisdiction authority over the corporation's operations (other than its compliance with the requirements of the corporations statute); rather, the authority over the operations is determined by what level of government has jurisdiction over the activities in question (e.g., a nationally incorporated educational institution falls under provincial jurisdiction with respect to its operations; the activities of an airport authority fall under federal jurisdiction no matter where it is incorporated).

Jurisdiction of the federal government

Aside from statutes governing incorporation and corporate regulation, the federal government's jurisdiction over the not-for-profit sector is manifested most extensively in the *Income Tax Act*. This jurisdiction is exercised both in the determination of non-profit status and of status as a registered charity. The basis of this involvement is the federal power over direct and indirect taxation. (Chapter 7 addresses the taxation status of not-for-profit entities in greater detail.)

Depending on the purposes and activities engaged in by the organization, the federal government may also have regulatory jurisdiction – for instance, port authorities are subject to regulation by the federal Department of Transport.

In addition, the federal government shares jurisdiction with provincial governments regarding sales and consumption taxes, and consequently has a say in how that aspect of the taxation system is applied to not-for-profit entities. In some cases, not-for-profit corporations are eligible for a preferential GST rate.

Federal regulation of such areas as trade and commerce and privacy also gives it jurisdiction over certain aspects of the activity of not-for-profit corporations. Finally, federal spending can give it authority over some not-for-profit work.

Jurisdiction of provincial governments

Aside from statutes governing incorporation and corporate regulation, provincial governments have considerable jurisdiction with respect to the not-for-profit sector. Some examples include:

- **Supervision of charities.** The Office of the Public Guardian and Trustee in Ontario supervises most public benefit organizations – i.e., corporations incorporated for a religious, charitable or public purpose – operating in Ontario regardless of where they are incorporated, and whether or not they have been registered with the Canada Customs and Revenue Agency.
- **Fundraising.** The Alberta government has legislative measures in place to monitor and control fundraising activities. Manitoba also has legislation dealing with registration of fundraising organizations.
- **Gaming and lotteries.** Whether through charity bingos, casinos or raffles, or provincial government funding from gaming or lotteries, this represents a huge area under provincial jurisdiction affecting not-for-profit entities.
- **Professions.** Education is a provincial responsibility. Such matters as the tax deductibility of education fees, professional self-regulation, and the right to grant a protected designation or certification are all

matters addressed provincially.

- **Property taxation.** Various provinces (acting directly or through their municipalities) either exempt certain not-for-profit entities from property taxes or provide lower assessment rates, depending on the type of organization.
- **Taxation.** In Québec, provincial legislation provides for a distinct taxation regime – which roughly parallels the federal system – that contemplates exemption of non-profit organizations and registration of charitable organizations. It also establishes a distinct system of sales and consumption taxes.
- **Language.** In Québec, the *Charter of the French language* and the *Act respecting the legal publicity of sole proprietorships, partnerships, and legal persons* requires and regulates the use of the French language for the names of not-for-profit corporations as well as their contracts, signs, posters, leaflets, brochures, etc.
- **Registration.** All not-for-profit corporations carrying out activity in Québec must register and subsequently file an annual declaration in conformity with the *Act respecting the legal publicity of sole proprietorships, partnerships and legal persons.* The Act provides for fines for the corporations and its directors for non-compliance.
- **Funding.** Health care, for instance, is a provincial responsibility. Provincial governments provide funding related to health care delivery, education, etc.
- **Regulation.** Provincial governments have jurisdiction over many of the activities most commonly undertaken by not-for-profit entities through their constitutional authority over property and civil rights.
- **Freedom of Information and Privacy.** Some provincial governments have implemented legislation that focuses on the freedom of information and privacy.

Jurisdiction of the courts

Other than enforcement of legislation, there are at least three notable areas where various courts have jurisdiction over not-for-profit corporations:

- having inherent power to supervise the activity of organizations to ensure their proceedings accord with the requirements of procedural fairness;
- determining whether the purposes and activities of an organization are charitable, and therefore whether it is eligible for status as a federal or Québec registered charity; and
- where an organization is a charity, having inherent power to supervise treatment of the assets of the organization as trust property.

Conflicting or mixed accountability

Directors should always be aware that they may be accountable to different parties. By-and-large it should be possible to reconcile the responsibility owed to these various constituencies. When they cannot do so, directors should seek legal advice and make decisions based on a full understanding of the implications.

EXAMPLE

If the organization is on the verge of insolvency and is offered funding for a project that is apparently beyond the scope of its objects or purposes, the directors need to seek legal advice to assure themselves that the proposed work is within their mandate, or to determine how to bring it within their mandate, should they decide to do so.

ELEMENTS OF GOOD GOVERNANCE

Recommended practices for not-for-profit boards of directors

The *Panel on Accountability and Governance in the Voluntary Sector*,[14] chaired by Ed Broadbent, identified eight tasks required of the boards of charities and public-benefit not-for-profits[15] to further develop effective governance:

- steering toward the mission and guiding strategic planning;
- being transparent, including communicating to members, stakeholders and the public and making information available upon request;
- developing appropriate structures;
- ensuring the board understands its role and avoids conflicts of interest;
- maintaining fiscal responsibility;
- ensuring that an effective management team is in place and overseeing its activities;
- implementing assessment and control systems; and,
- planning for the succession and diversity of the board.

The tasks highlighted in this list could be elaborated on at length. Here the list is offered merely as a starting point to indicate the issues that directors need to consider. Each organization should look at its own circumstances to determine the particular areas it should focus on, and what, if any, additional elements need to be added to the list for their purposes.

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SAMPLE QUESTIONS FOR PROSPECTIVE OR CURRENT DIRECTORS TO ASK THE ORGANIZATION

1) Is the organization incorporated and, if so, in what jurisdiction and under what legislation?
2) Is the corporation primarily for the mutual benefit of its members, or is it primarily for public benefit?
3) What is the mission of the organization and when was it last reviewed?
4) Who are the members of the corporation?
5) Who does the corporation serve – the members or some other constituency?
6) To whom are we, as directors, accountable?

SAMPLE QUESTIONS FOR PROSPECTIVE OR CURRENT DIRECTORS TO ASK THEMSELVES

1) Am I committed to the mission of the organization?
2) Can I contribute the time necessary to be an effective board member?
3) Am I comfortable with the approach and tone of the organization's fundraising efforts?
4) Can I contribute financial support consistent with the organization's expectations of board members and with my own means and priorities?
5) Can I place the organization's purposes and interests above my own professional and personal interests when making decisions as a board member?

CORPORATIONS & DIRECTORS CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. A review of the letters patent (articles of incorporation)	Full board (possibly with assistance from advisor and/or counsel)	Annually, or as frequently as is appropriate given the length of board terms and the board turnover rate	Is there any deviation between the organization's mission statement, and the purpose as defined in the letters patent or articles of incorporation? Has the organization complied with corporate filing requirements?
2. A compliance review of the bylaws	One of: the full board/ executive committee/bylaw committee (possibly with assistance from advisor and/or counsel)	Annually, or as frequently as is appropriate given the length of board terms and the board turnover rate	Do the bylaws comply with current corporate and tax laws as they apply to not-for-profit corporations? Has the organization changed, or is it considering change, necessitating amendment of the bylaws? Do the bylaws contain the purpose of the organization and, if so, is it consistent with the purpose and/or mission described elsewhere?
3. A best practice review of the bylaws	Full board and/or executive director (possibly with assistance from advisor and/or counsel)	Annually	Do the bylaws represent existing best practice? Are amendments or updates to the bylaws needed? Are there any unnecessary bylaws, given the corporation's current size and state? Are there logical gaps in the bylaws that should be addressed?

4. An electoral process review of the bylaws	Executive director and/or the nominating committee	Annually, in advance of the nomination and election process	What are the milestones that must be met in the nomination and election process (e.g., the timeline)? Does the number of directors comply with the bylaws? Does the nomination and election process comply with the bylaws?
5. A review of the mission statement	Full board and the executive director	Annually	The questions in the Mandate section of this chapter (see pg. 7) should be answered to ensure that the mission statement is still relevant.
6. A review of the governance approach used by the organization	Full board with input from members	Every two years; more frequently if board turnover is high	Is the board the right size? Is it doing the right job (see Broadbent recommended practices in this Chapter)? Does the organization have good governance, and how could it be improved?

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Duties of Directors

Jane Burke-Robertson*
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INTRODUCTION

The role of directors

The board of directors of a not-for-profit corporation is responsible for the management of the corporation. In general terms, this means that the board is responsible for supervising senior staff, providing strategic planning to the corporation, and developing and implementing corporate policy. Board members must be (or at least must become) knowledgeable about the business and financial affairs of the corporation. Where the corporation is a charity, the board has a heightened duty of care with respect to the protection of its charitable property.

In discharging its mandate to manage the corporation's affairs, the board must comply with the objects of the corporation as stated in the letters patent or articles of incorporation and with the bylaws of the corporation. The board must also comply with the relevant provisions of the corporations statute under which the corporation is incorporated and the rules established under the common law (the law established by courts) governing directors' duties.

The duties of directors

Directors are required to exercise their power with competence (or skill) and diligence in the best interests of the corporation. They owe what is called a "fiduciary duty" to the corporation. The duty is a "fiduciary" duty because the obligation to act in the best interests of the corporation, at its core, is an obligation of loyalty, honesty and good faith. Modern corporations statutes governing business corporations provide a concise formulation of the fiduciary obligation owed by directors. Most of the corporations statutes governing not-for-profit corporations do not. The formulation of the fiduciary duty of directors has been developed at common law by Canadian and English courts or set out in the *Civil Code*.

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Directors' fiduciary duties can be divided into two main branches:

a) the duty of care; and,
b) the duty of loyalty.

The duty of care imposes on directors a duty of competence or skill – i.e., a requirement to act with a certain level of skill; and a duty of diligence. The duty of skill and diligence must be performed to a certain "standard of care".

What level or kind of skill must a director demonstrate? What level or kind of diligence?

For not-for-profit corporations, the answers to these questions are to be found in any one of or any combination of the following sources:

- the legislation under which the corporation is incorporated;
- court decisions which attempt to define the standard of care expected of directors;
- non-corporation laws and statutes which impose additional specific duties on directors;
- in trust law, for not-for-profit directors of a corporation organized to pursue charitable purposes; and,
- in Québec, the directors' duties found in the *Civil Code of Québec*

It is generally accepted that a heightened duty of care is owed by directors of a charitable not-for-profit corporation.

The duty of loyalty requires that a director act honestly and in good faith in the best interests of the corporation. The duty of loyalty is a personal duty and cannot be delegated (the "no-delegation rule"). Among other implications, it means that a director is not allowed to profit from his or her office (the "no-profit rule") and must avoid all situations in which his or her duty to the Corporation conflicts with his or her interests (the "no-conflict rule").

The civil responsibility of directors

In law, a corporation is a distinct legal entity. It has a separate legal personality from its directors, members and other stakeholders. As a separate legal entity, the corporation can own property, enter into contracts, be responsible vicariously for the civil wrongs ("torts") of its employees, and sue and be sued in the courts. It thus has "civil capacity". Directors and members are not generally, personally liable for the contracts and torts of the corporation.[1] When a director properly signs a contract on behalf of the corporation, only the corporation is bound, not the director. As a general rule, when an employee of a corporation commits a tort, only the corporation, (as employer), and the employee, are responsible, not the director.

Directors are responsible, however, for breaches of their fiduciary duty to the corporation. They can also be held personally liable for breaches of a growing number of statutory provisions that impose responsibility on them as directors (see Chapter 3). Directors are also liable for the torts that they commit themselves, even if committed while executing their responsibilities as a director. In general, if directors commit a tort, the fact that they were acting as directors when doing so will not be an excuse.

THE DUTY OF CARE

(A) The Duty of Skill or Competence

In carrying out their obligations, directors of not-for-profit corporations must use an appropriate degree of skill. The common law holds that what is known as a "subjective" standard applies to directors of not-for-profit corporations incorporated under the *Canada Corporations Act* or under provincial incorporation statutes, unless those statutes set out a different standard. In some provinces, what has been described as an "objective" skill standard has been set out in legislation. This standard is discussed below. The subjective standard requires that directors:

> …exercise such degree of skill and diligence as would amount to the reasonable care that an ordinary person might be expected to take in the circumstances on his or her own behalf, but he or she need not exhibit in the performance of his or her duties a greater degree of skill than may be expected from a person of his or her knowledge and experience.[2]

The standard is subjective in the sense that it incorporates a reference to the particular abilities of the particular director. Since the standard is subjective, it can be applied differently among board members of a given corporation. For instance, a lawyer or an individual with business experience will be held to a higher standard of care than someone with less education or experience.

In contrast, under an objective standard of care all board members – regardless of background or experience – are assessed against the same benchmark. The most commonly used objective standard is the conduct that might be expected of a reasonably prudent person. A higher objective standard, which has never been applied by a court, is the conduct that might be expected of a reasonable director.

Even when the subjective standard of care applies, this does not mean that a director with few skills or little experience will escape liability. The conventional wisdom is that such a director is required to act in accordance with conduct expected of a reasonably prudent person. This means that a director without the skills required to meet that standard is obliged to acquire them, or some of them. A director must become informed if he or she is not already knowledgeable.

A lack of case law in this area means that it is impossible to determine with any certainty what distinctions would be made by the courts between the subjective and objective standards of care. Owing to the deference shown by courts to business decisions, and the difficulty of tracing a decision back to the particular skill level of a director or directors, the difference between the two standards may be more perceived than real.

Even so, where the subjective standard applies, this can make it more difficult to attract highly-skilled, experienced or professional nominees for the boards of not-for-profit corporations.

However, the common law has imposed some reasonable limitations on what can be expected of directors:

- a director is not liable for mere errors in business judgement (e.g., considered decisions to pursue a particular commercial course made after honest and good faith evaluation);

- directors are justified in entrusting certain matters of business to officers of the corporation; and,
- directors are justified, in the absence of grounds for suspicion, in trusting that officers of the corporation will perform their duties honestly.[3]

In practical terms, the following applies:

■ Directors should make decisions affecting the corporation based on full consideration of all appropriate material and on the advice of professionals where required.

■ Directors should oversee all aspects of the corporation's operations.

■ Directors may delegate certain functions to key senior management, but must maintain a supervisory role.

The board of directors is responsible for regularly reviewing the performance of senior staff to whom they are entrusting the implementation of the corporation's mandate on a daily basis.

(B) The duty of diligence

SYNOPSIS

The duty of diligence requires a director to attend meetings and to become as fully informed as possible regarding all aspects of the corporation, including any issues that affect the corporation.

Directors have a duty of diligence in their management of the affairs of the corporation that requires, to the greatest possible extent, regular meeting attendance and development of a sound knowledge of all aspects of the corporation. As noted above, under the *Canada Corporations Act* there is no duty for directors to have a particular skill level. They are only required to act within their particular knowledge and skill level.

The duty of diligence refers to the obligation of directors to educate themselves about the corporation's mandate and all aspects of its operations. It is not enough to merely attend board of directors' meetings. The duty of diligence requires active and concerted effort on the part of directors to be knowledgeable and ready to make informed decisions affecting the corporation.

Practical implications

The duty of diligence has a number of practical implications. Directors should:

- ensure that the board of directors meets regularly;
- attend meetings of the board of directors whenever reasonably possible;
- be thoroughly informed about any decisions the board has to make and ensure that they are provided in a timely manner before the board meeting with all relevant documents including agreements, financial reports and information, legal opinions and other information necessary to make knowledgeable and informed decisions at the board meeting;
- exercise independent judgement when voting in all corporate decisions, and not simply vote with the majority for no well-informed reason;
- ensure that minutes of meetings of the corporation accurately reflect any comments or votes in opposition to matters acted upon;
- carefully review all reports relating to the corporation's financial affairs, including interim and year

end financial statements;
- with the assistance of senior staff, carefully review and participate in formulating the annual budget and strategic plan;
- understand and comply with the stated purposes of the corporation as provided for in the letters patent of the corporation;
- understand and carry out their obligations under the corporation's bylaws, including the requirement to call an annual general meeting and to provide information to the members at that meeting;
- require senior management to provide them with any ongoing operational and program information;
- monitor and supervise the chief staff person and regularly assess his or her performance;
- be aware of all internal policies affecting the organization and ensure that certain key policies are in place (such as an investment policy and conflict of interest policy); and,
- be aware of the laws affecting the corporation and obtain necessary legal and accounting advice.

Attendance at board meetings

Although directors are not legally obliged to attend board meetings, their consistent failure to do so would likely be a breach of a director's duty of diligence.

In most provinces and under the *Canada Corporations Act*, directors cannot vote or participate in meetings by proxy. This is legislative recognition of the importance of full participation by directors at board meetings. Discussion of issues and participation in debate are an essential part of a director's role; his or her responsibility cannot be fulfilled merely through a proxy.

Screening

Allegations of sexual, physical and/or emotional abuse by staff or volunteers of not-for-profit corporations are increasingly commonplace. In light of this, particularly where the corporation is dealing with a vulnerable client population, directors need to consider whether fulfilling their duty of diligence requires ensuring this issue is addressed by the organization in some way. This could involve implementation of a screening protocol (see Chapter 6 for more information on screening).

To date, no court has found that a director failed to discharge this duty because screening or other measures were not taken by the board to lessen the risk of such abuse. However, given the profile of this issue and findings of significant organizational liability against some not-for-profit corporations in recent cases, it is foreseeable that in the future courts may hold directors accountable if their corporations do not take steps to lessen the risk of abusive conduct.

(C) Charitable corporations

Directors of charitable not-for-profit corporations

SYNOPSIS

Where a not-for-profit corporation is also charitable (a "charitable corporation") then as well as the standard of care generally applicable to not-for-profit directors, board members may be required to meet additional expectations – particularly when the corporation carries on all or some of its activities in Ontario.

The law is unclear about the extent to which directors of charitable corporations are considered to be trustees. Generally speaking, however, directors of charitable corporations should meet the standard of care expected of someone in charge of property that is subject to a trust – a "trustee standard".

Among the requirements of this standard, directors must exercise a degree of skill and prudence comparable to a reasonable business person caring for his or her own affairs.[4] The "trustee standard" is generally considered a more demanding standard in law, and goes beyond what is ordinarily expected of either a not-for-profit or a for-profit director.

Directors should realize that a corporation does not have to be registered as a charity with Canada Customs and Revenue Agency to be considered a charity at common law. In Ontario, the Office of the Public Guardian and Trustee takes the position that all monies entrusted to a public benefit not-for-profit corporation as defined in the *Charities Accounting Act* are monies given for a charitable purpose. As such, the persons responsible for managing those monies must do so as if they were trustees. In Québec, no such higher standard exists for directors.

Specific duties relating to special purpose trusts

Directors of charitable corporations have particular responsibilities relating to special purpose trusts such as restricted trust funds and special purpose trust funds. Where the corporation holds the monies or assets under such trusts, its ability to use them is severely constrained.

EXAMPLE

A special purpose trust is established to fund a particular educational conference. If a donor is led to believe by the corporation that his or her gift will be used to fund the conference, a special purpose charitable trust is created and the money must be used for this purpose. This also applies where an endowment is created for a particular purpose or subject to the requirement that it be held for a particular period of time.

Where a charitable corporation holds restricted trust funds or endowment funds, the corporation and its directors may be considered to be or treated as trustees of those assets. Their overriding duty is to carry out the restrictions attached to this special purpose charitable trust. In other words, they must make sure that the gift is used for the purpose for which it was given and for no other purpose.

If a charitable corporation fails to comply with the terms of a special purpose trust, all of the directors of the charitable corporation will be in breach of trust. In their personal capacity, individually and as a group, they will be liable with the corporation for the full amount of the loss suffered by the trust fund as a result of the failure to comply with the terms of the trust.[5]

Some instances in which directors may be found liable for breach of trust are:

- The charitable corporation uses a fund that the donor gifted for use in a particular charitable program to cover the charitable corporation's operating or administrative expenses.

- The charitable corporation uses money from a public fundraising appeal for different charitable purposes from those communicated to the public without obtaining court authorization.
- The charitable corporation places funds into a perpetual endowment fund when all of the monies were intended by the donor to be spent on a current program of the charitable corporation.
- The charitable corporation encroaches on the capital of an endowment fund that was intended by the donor to be held in perpetuity.
- The charitable corporation borrows from a donor-restricted charitable trust fund even where there is a *bona fide* intent to repay those monies together with interest.

Not all conditions placed on gifts by donors will turn a gift into a special purpose trust or another type of restricted gift, however. Each situation must be analysed to determine whether the restriction is sufficient to constitute a special purpose trust. Where there is any uncertainty about whether a special purpose trust or restricted gift has been created, appropriate legal advice should be sought.

Practical implications

The higher duty of care for directors of charities has a number of practical implications. Directors of charities should play an active role in managing their corporations' assets in order to meet this higher duty of care. This means that directors should, at a minimum:

- actively oversee the operations of the corporation and ensure that all programs are permitted by the corporation's charitable objects;
- oversee the corporation's fundraising program so that they are aware of the fundraising methods being employed by staff or professional fundraisers that may result in a special purpose trust fund being created;
- be aware of the terms of any special purpose trust funds and comply with those terms;
- apply for a court order to modify the terms of the trust if the terms of any special purpose trust are no longer capable of being fulfilled by the charitable corporation;
- ensure that all charitable donations, particularly special purpose trusts, which are not to be used for immediate purposes, are properly invested;
- invest property from donations in accordance with the letters patent of the charitable corporation and if the letters patent are silent, then in accordance with the applicable provincial trust legislation (e.g., in Ontario, this is the *Trustee Act* [6]);
- comply with their duty to protect and conserve the trust property under their administration;
- keep proper books of accounts with respect to the affairs of the charitable corporation, including donor restricted charitable trust funds[7]; and,
- never allow himself/herself to be in a position that results in a conflict of interest in the duties owed by the directors to the corporation.

DUTY OF LOYALTY

SYNOPSIS

Directors must act with honesty and in good faith in what they reasonably believe to be the best interests of the corporation.

As noted above, the position of a director with respect to the not-for-profit corporation is that of a fiduciary. As a result, a director is considered to be acting for the corporation's benefit, and must subordinate his or her personal interests to the best interests of the corporation. In Québec, directors must by law "act with honesty and loyalty in the best interest of the legal person",[8] which is the civil law codification of the common law fiduciary duties.

This duty of loyalty involves good faith, trust and special confidence, and is the same whether the corporation is a business corporation or a not-for-profit corporation. It requires high standards of honesty and good faith in the exercise of a director's powers and discretions. It means that a director must always use his or her powers in the best interests of the corporation. The director may not delegate his or her duty, except under certain circumstances and with adequate supervision; the director must not profit from his or her position and must always disclose the entire truth in his or her dealings with the corporation; and, the director must avoid all conflicts of interest.

A director will never be able to discharge his or her obligations in meeting the duty of care if the director has acted in bad faith. Intentional dishonesty, incomplete or misleading representations, and acting from an improper motive can all be characterised as bad faith. The 'good faith' requirement is the core of the fiduciary relationship and requires a director to act with pure intentions and with a view to serving the best interests of the corporation.

Directors may not abuse their powers by exercising them for an improper purpose, – i.e., in order to give themselves an advantage or to confer an advantage to someone else, or in order to unduly discriminate against a person – without their act being justifiable by the best interests of the corporation.

For instance, they may not use their power by admitting only members sympathetic to them and refusing to admit or expelling members because they are not.

Not only could such improper actions be set aside by a Court, but they may also result in the personal liability of the directors towards the corporation and the injured persons.

Practical implications

The duty of honesty and good faith has various practical implications. Directors must:

- disclose the entire truth in their dealings with the corporation and actively avoid any impropriety or dishonesty;
- have full allegiance to the corporation's mission and further its cause;
- resign as a director where the director has any personal prejudices or beliefs that are inconsistent with the corporation's mission and that might interfere with the duties owed to the corporation;
- place the interests of the corporation above personal self-interest in all dealings with the corporation and actively avoid all potential conflicts of interest;

- fulfill all of the corporation's reporting obligations with honesty and good faith, and accurately represent the corporation's financial or other position;
- maintain adequate and accurate books of account, records and minutes of the corporation;
- ensure that all corporate decisions are implemented in accordance with the applicable board resolution;
- accurately portray the corporation's programs and objectives to the general public and to any requesting government authority;
- not disclose any information acquired in connection with their position as directors that might be harmful to the interests of the corporation and that is not already available to the public; and,
- fulfill the terms and restrictions of any special purpose trust fund maintained by the corporation, honestly and in good faith.

Non-delegation

SYNOPSIS

A director must not delegate his or her general responsibility for governing the corporation. In certain circumstances it is permissible to delegate particular tasks related to management of the corporation, provided there is proper supervision of the party to which the task is delegated.

Directors are entitled to delegate some of their responsibilities to committees, officers, or members of the corporation. In Québec, directors of *Companies Act* corporations may not delegate powers to any committee other than an executive committee composed exclusively of directors and created by a bylaw adopted by 2/3 of the members present at a special meeting. In other jurisdictions delegation powers are not so prescribed, however wholesale delegation – most obviously, where a director purports to give over all his or her responsibilities as a director to another person – is never permitted. Such an action would usurp the role of the corporation's members in electing directors.

The fact that directors have delegated a particular task does not relieve them from responsibility, and they should always supervise the carrying out of the task. Directors should remember that they are ultimately accountable for the overall management of the organization.

Delegation of core responsibilities, such as giving an executive committee authority to bind the corporation, should be contemplated in the bylaws. If such delegation is not addressed in the bylaws, or alternatively in an explicit resolution of the full board setting out the terms of the delegation, actions or decisions taken by the body to whom the delegation was made may be subject to challenge. Generally, the broader the delegation, the stronger the argument to be made that it needs to be contemplated in the bylaws.

The line between governance and operational matters is often unclear. As a general rule, it is best to limit delegation of core functions to board committees authorized by the bylaws. Other matters may be delegated by way of board resolution.

The terms of reference of any delegation, whether found in the bylaws, resolutions or both should set out the scope and duration of the delegation, the requirements for reporting back to the full board, and the relationship between the board and the body to which the matter is delegated. (See chapter 5 for further information on the relationship between boards and various types of committees.)

Non-delegation by directors of charities

Where directors of charitable corporations may be considered to be trustees, their ability to delegate decisions with respect to treatment of charitable property may be even more constrained. At common law, trustees may not delegate any such decisions. In certain jurisdictions, delegation by trustees of some aspects of their responsibility is permitted, subject to prescribed restrictions, under provincial trust legislation or regulations.

The No-profit rule and the No-conflict rule

> **SYNOPSIS**
>
> *Directors must act with loyalty at all times. The duty of loyalty requires directors to stringently avoid conflicts of interest. Directors may not profit in any way from their relationship with the corporation. If they do, they must account to the corporation for the profit. Directors cannot place themselves in a situation where their duty as a director conflicts with their interest or with their duty to others.*

A director must give undivided loyalty to the corporation he or she serves. Directors should not put themselves in a position that would create a conflict between their duty to act in the best interests of the corporation and their own personal interest.[9] In general terms, this means that a director should not have any personal interest in any proposed contracts with the corporation. Nor should a director take personal advantage of opportunities that arise because of his or her association with the corporation.

While a conflict of interest can result from many circumstances, there are two general ways in which a director can find himself or herself in a conflict of interest:

- There can be a personal conflict between a director's duty to act in the best interest of the corporation and his or her own self-interest, such as where a director stands to gain financially from a proposed contract between the director (or his/her company or firm) and the corporation;
- There can also be conflict in duties owed to another, where a director's duties to the corporation he or she serves conflict with duties that the director owes to another person or corporation. This can happen when the director is a director of two corporations, or is the director of one corporation and serves the other in another capacity, and the two corporations are involved in one or more transactions.

Personal self-interest conflicts

Directors should not put themselves in a position that would create a conflict between their duty to act in the best interests of the corporation and their own personal interest.[10]

The courts have shown very little flexibility on this point by insisting that directors avoid not only actual conflict but also the appearance of conflict. The common law principle with respect to directors' conflicts is straightforward – directors may not have an interest in a contract or transaction being entered into by the corporation.

Personal self-interest can include a situation in which the director stands to gain personally, either directly or indirectly, through a business or corporation involved in the transaction.

EXAMPLE

A director applying, or being recruited, for a staff position or contract work of a corporation of which he or she is a director is in a personal conflict of interest.

This restriction may extend to a situation in which relatives or friends of the director stand to receive a benefit. It can also include corporate opportunities that the director learns of in advance of others and that the director takes advantage of to the detriment of the corporation.

EXAMPLE

A director setting up his or her own corporation to tap a potential market identified through the research conducted by the corporation of which he or she is a director is in a personal conflict of interest.

In some cases – but not in the case of charitable corporations or where directors could be considered trustees – an otherwise improper benefit gained by a director may be permitted. The legislation under which the corporation was incorporated may provide for a means of 'ratifying' contracts in which the director has an interest. This generally requires the director to declare his interest and to abstain from voting. The contract can then generally proceed and the director can retain any profit realized.

If the not-for-profit corporation's governing statute does not provide a means of 'ratifying' the contract and a director has an interest in a contract with the corporation, the corporation may recover from the director the profits that the director gained from the contract. Where the corporation is a charity or where directors could be considered trustees, trust legislation precludes 'ratification' of this type of transaction.

In Ontario, directors of charitable corporations are prohibited by common law from realizing any benefits, either directly or indirectly, from their position as a director or otherwise. This means that a director of such a corporation carrying on activities in Ontario would typically not be able to take advantage of ratification of contracts in which he or she has an interest if this would result in a direct or indirect benefit to the director.

Where a director has a conflict of interest and he or she fails to act properly (i.e., by declaring the conflict and following the procedure in the incorporating legislation), the director must repay any benefit resulting from the transaction to the corporation.

Conflict in duties owed to another person or organization

A conflict of interest can arise where a director's duties to the corporation which he or she serves conflict with duties that the director owes to another person or organization.

Where an individual is a director of two corporations, or is a director of one corporation and serves as staff or in another capacity with another organization, that have dealings with each other, the individual's duty to both entities can lead to a conflict of interest. This can arise if the interests of the two entities are not in harmony and the director cannot discharge his or her obligations to one without acting against the interests of the other.

EXAMPLE

A director of a corporation who is also a staff member of an organization that is a funder of that corporation may face a conflict of interest where he or she wants to direct use of funding in a particular way that might not be in the best interest of the corporation.

A conflict of interest may also arise from conflicting duties owed by the director to two corporations of which he or she is a director, or where he or she is a director of one corporation and serves as staff or in another capacity with another organization (as opposed to a conflict that is based on a particular transaction or contract).

EXAMPLE

This may happen when an affiliated organization is represented on a corporation's board of directors. As the mandate of the two organizations evolve over time, one organization may want to move away from providing support or complementary services to being the exclusive service provider. So the question of merging the two organization or folding one of them may arise. Once this has been contemplated, it may be impossible for the individual to continue to hold both positions.

When an organizational conflict of interest becomes apparent at a meeting of the board of directors, the director should declare the conflict. He or she should then leave the room for the discussion and abstain from voting on any matter that affects the other corporation of which he or she is a director or employee. If the conflict is insurmountable, the director may have to resign from one or both corporations.

Both the corporation and the directors should have a clearly defined policy to follow in the event of a conflict of interest. However, the legal validity of any policy that allowed a board to disregard a conflict of interest in breach of its fiduciary obligations is doubtful.

Relief of conflicts of interest in incorporation statutes

For federally incorporated organizations, conflicts of interest resulting from a particular transaction can be dealt with under the remedial provisions of the governing statute. Some provincial corporation statutes, as well as the *Civil Code of Québec*,[11] also provide procedures to cure such conflicts of interest. Non-contractual conflicts of interest must be dealt with in other ways.

Under section 98 of the *Canada Corporations Act*, a director has a duty to declare his or her direct or indirect interest in a contract or proposed contract with the corporation at a meeting of the board of directors. The Act sets out certain minimum requirements to address the conflict. The procedure outlined in the Act can be used in situations where a director:

- has a personal interest in a proposed contract with the corporation;
- has an interest in a contract with the corporation because he or she serves as an employee, or in another capacity, in another corporation with which the corporation is contracting; or,
- has an interest in a contract with the corporation as

a result of being a director in another corporation with which the corporation is contracting.

In the last circumstance, even if the procedure is followed, the contract may not be legally valid where the overlap between the two organizations is such that the majority of directors on the board of the contracting corporation are directors of the other corporation.

Where a not-for-profit corporation incorporated under the *Canada Corporations Act* wishes to enter into a contract with another corporation or firm in which one of its directors has a direct or indirect interest, the following applies:

- In the case of a proposed contract, the director must declare his or her interest at the meeting of directors at which the question of entering into the contract is first considered.
- Where a director becomes interested in a contract after it is made, the declaration must be made at the first meeting of directors held after the director becomes interested.
- The director's declaration of interest can take the form of a general notice to the directors of the corporation to the effect that he or she is a shareholder of or is otherwise interested in the other company or firm, or is a member of a specified firm, and is to be regarded as 'interested' in any contract made by the corporation with that company or firm.
- The director who has declared a conflict should not vote on any contract in which he or she is interested.
- The prohibition against voting in these circumstances does not apply (1) in the case of any contract by the corporation to give to the directors any security for advances or by way of indemnity (e.g., where the board approves the purchase of directors and officers liability insurance); (2) where there isn't a quorum of directors in office who are not interested in the particular contract (see above: such a contract may be held not legally valid); or (3) if the director is a director or officer in the other company and holds only that number of shares which is required to qualify him or her as a director (e.g., if the director's interest in the other corporation is limited to the minimum mandatory amount that must be held by any director).

Relief of conflict of interest by courts (in the case of charities)

In Ontario, a director of a charitable corporation who stands to profit as a result of a contract in which he or she has an interest may not continue to serve the corporation as a director without court authorization.

Under the *Charities Accounting Act*, a procedure is provided for court authorization of trustee conflicts of interest. As the *Act* deems directors of Ontario public benefit corporations to be trustees, they are eligible for this court-authorized relief.

Receiving any personal benefit from a charitable corporation while sitting as one of its directors is considered to be a conflict of interest. Therefore, for a public benefit not-for-profit corporation carrying on activities in Ontario:

- a director may not receive any payment for services as a director or receive any benefit or payment from the charity, directly or indirectly in any other capacity, without court approval; and
- the corporation may only provide an indemnity and purchase directors and officers liability insurance on

behalf of its directors provided that they meet the requirements set forth in Ontario Regulation 4/01 under the *Charities Accounting Act*. (For more on this, see Chapter 6.)

This position is enforced at least in part through the supervision of the Office of the Public Guardian and Trustee of Ontario.

A director of a charitable corporation in another province, who may potentially be deemed a trustee owing to the nature of a corporate dealing, may in some cases be able obtain court relief from the conflict by making an application based on trust law.

Practical implications

The duty of loyalty and duty to avoid conflicts of interest have a number of practical implications. Directors should:

- demonstrate full allegiance to the corporation's mission and further its cause;
- approve a conflict of interest policy which includes guidelines on the circumstances in which directors will be considered to be in conflict and the appropriate remedies for failing to disclose a conflict;
- not disclose any information acquired in connection with their position as directors that might be harmful to the interests of the corporation;
- not disclose or use any information relating the affairs of the corporation for personal profit or advantage;
- place the interests of the corporation above personal self-interest in all dealings with the corporation;
- carry out all of their duties in the best interests of the corporation;
- actively avoid all conflicts of interest and immediately disclose any actual or potential conflict, real or perceived, to the board of directors;
- ensure that minutes of any meeting at which a decision involving a potential conflict of interest is discussed accurately reflect the views of all conflicted and non-conflicted directors;
- obtain a legal opinion where there is uncertainty as to whether a conflict of interest exists;
- resign where a director is a director of two corporations, or serves as a director of one corporation and in another capacity in the other corporation, where the interests of the two entities are in conflict and it is apparent that the director cannot act in the interests of one corporation without acting against the interests of the other.

DUTIES TOWARDS MEMBERS*

Directors have certain duties to the members of the corporation. They must ensure that the corporation and its directors abide by the terms of its letter patent and bylaws, which have been considered by the courts as akin to a contract between the corporation and its members.[12]

Directors must also treat all members equally (for instance, by fixing or collecting dues or enacting rules or bylaws), unless the best interests of the corporation clearly require otherwise.

Directors must tread especially carefully in the sensitive and litigation-rich area of members' discipline.

Before suspending, fining, expelling or refusing to readmit a member, directors must make sure that the bylaws of the corporation clearly empower them to do so, and that all the internal procedural steps they set out (notices, delays, inquest and recom-

* This section prepared by Paul Martel, LL.L., LL.M., of the Montreal office of Fasken Martineau DuMoulin LLP.

mendation by a committee, hearing, internal appeal, etc.) have been strictly adhered to.

The proceedings must afford a reasonable degree of procedural fairness – i.e., fair play and good faith. The disciplined member should be given fair notice, and an opportunity be to be heard (and have counsel present) in his own defence by board members open to persuasion.[13] Otherwise, the board's decision will be subject to review by a Court. Directors must be careful not to impinge on the member's reputation, for example by publicising at large his expulsion and the motives thereof, or by having a general meeting of members ratify it when a board resolution is sufficient according to the bylaws. They stand to be personally sued for damages if they do.

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Sample questions for prospective or current directors to ask the organization

1) Does the board of directors meet regularly? How often does it meet?

2) What notice and preparation (e.g., agendas, reports, etc.) does the corporation give to directors in advance of board meetings?

3) Does the corporation have written policies such as a conflict of interest policy and an investment policy?

4) Does the corporation maintain the proper books of account, records and minutes of meetings?

5) Does the corporation provide board members with ongoing operational and program information?

6) How does the board monitor and supervise the chief staff person? Does it do an annual performance appraisal of this person?

Sample questions for directors to ask themselves

1) Do I understand the duties of a director of a not-for-profit corporation?

2) Do I attend board meetings regularly? Do I prepare adequately for them? Do I read materials and consider them carefully?

3) Do I exercise independent judgement when voting on corporate matters?

4) If I am serving on the board of a charitable corporation, do I understand the specific fiduciary responsibilities that I have?

5) Am I alert to any potential conflicts of interest or appearance of personal gain?

6) If I sit on the board owing to my affiliation with a stakeholder group, do I understand that my affiliation with that group cannot determine my vote on any board decision? Am I prepared to declare a conflict of interest, and in some cases resign, if I am unable to reconcile my role with the stakeholder group and my position as a director?

7) Have I read and do I understand the corporation's policies on matters such as investment and conflict of interest?

DUTIES CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Procedures for distribution of material	Chair and executive director	Annually	A benchmark should be established that enables board members adequate time to consider material; limitation of the volume of material should also be considered, where the amount of material prevents directors from giving it adequate attention.
2. Director attendance record	Chair and individual board member	Annually	Does the director attend frequently enough to make a reasonable contribution to board deliberations?
3. Director performance re: preparation and familiarity with distributed materials	Chair and individual board member	Annually	Does the director regularly participate in board deliberations, and is this participation based on an informed understanding of the issues and materials relating to the matter being considered?
4. Is the director aware of, and discharging, his or her duties?	Chair and individual board member	Upon selection for the board, and annually after that	Is the director aware of, and discharging, his or her legal requirements vis-à-vis skill and diligence, loyalty, honesty and good faith, and avoiding conflict of interest?

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
5. Are there any additional duties placed on the director by the nature of the corporation or the activities it engages in?	Chair and individual board member	Upon selection for the board, and annually after that	Is the director aware of the extra requirements that may arise, for instance, from the corporation being a charity?
6. Is there a formal process in place for director performance review or removal?	Chair, executive director and/or nominating committee	Annually, in advance of the nomination and election process	Director performance review can be established by resolution, policy or other means. A process for removal of directors should be specified in the bylaws.
7. Is board business being fully discussed and completed?	Full board and the executive director	Annually	Feedback should be sought from directors both as individuals and as a group. It may be helpful to provide a means to share comments anonymously.
8. Is there a need to adopt specific policies that will assist board members in fulfilling their duties?	Full board	Annually	Directors should review their duties and consider any measures that will facilitate full and informed compliance with what is required of them. Is there a conflict of interest policy? Is there a screening policy?

3

Liability of Directors

Jane Burke-Robertson*
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INTRODUCTION

As a general rule, directors are not personally liable for the contracts of, or the actions or omissions of, the corporation that they serve because a corporation is considered to be a separate legal person at law.[1] The liability protection afforded to directors as a result of incorporation is often referred to as the "corporate veil".

However, there are exceptions to this general rule and there are many instances of directors' liability at common law, under federal and provincial statutes, and under the *Civil Code of Québec*. Directors of non-for-profit corporations should be aware of these exceptions. This chapter explains the liability exposure of directors.

The chapter is organized under the following headings:

- Liability and contracts (This relates to situations where directors enter into a contract without proper authorization or on behalf on a non-existent corporation.)
- Liability in tort (This relates to situations where directors' own actions are tortious.)
- Liability for breach of fiduciary duty (This is discussed in detail in Chapter 2).
- Liability for breach of trustee duties (This relates to situations where the corporation is a charity or directors deal with assets that are impressed with a trust).
- Common law liabilities (This relates to directors acting without proper corporate authority).
- Statutory liabilities (This relates to the numerous obligations imposed on directors under federal and provincial legislation).

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LIABILITY AND CONTRACTS

Directors are not usually personally responsible for contracts that they sign on behalf of the corporation, provided that they have proper legal authority to sign. The corporation's bylaws should contain a provision on directors' and officers' authority to execute legal instruments on behalf of the corporation.
The bylaws commonly also contain a clause providing that the board of directors may pass a resolution appointing specific directors or officers to sign on behalf of the corporation.

Note, however, that personal liability of directors for contracts can, in some cases, arise at common law or under statute if the corporation is not satisfactorily identified on documents. At common law, liability can arise where a director purports to enter a contract on behalf of a non-existent corporation. The relevant statutory provisions are discussed later in this chapter.

LIABILITY IN TORT

A tort is a civil wrong recognized by courts even though it may not be contemplated under statute, and for which the injured party may seek damages. Directors are not personally liable for torts committed in a corporate context unless their conduct itself is tortious.[2]

Although there is limited case law on the issue, particularly in the context of not-for-profit corporations, one possible instance of directors' conduct constituting a tort is the case of negligent mismanagement. Negligent mismanagement arises when the injury suffered by the tort victim can be attributed to carelessness in the oversight of some aspect of the corporation's operations. It relates to situations where the board knew of, or ought to have foreseen, a systemic problem and failed to address it.

EXAMPLE

Where the directors permitted an unsafe condition to exist on the corporation's property and that unsafe condition lead to a personal injury this could constitute negligent mismangement on the part of the directors and result in personal liability.

EXAMPLE

Where the board adopted a communications policy that resulted in, or failed to adequately safeguard against, libel and slander in corporate publications – such as where the practice of aggressively denigrating a corporate competitor is endorsed by the directors.

Directors' personal liability in tort may arise where the directors fail to adequately supervise the hiring of employees and volunteers or to adequately monitor the conduct of such employees and volunteers in their work for the corporation, particularly where there are allegations of sexual abuse of children and/or harassment of employees.

LIABILITY FOR BREACH OF FIDUCIARY DUTY

Directors who breach any of their duties to the corporation, as outlined in Chapter 2, may be liable if the corporation suffers a loss that can be directly attributed to their actions or omissions. To protect themselves from such liability, directors should always consider whether the decision(s) or action(s) being taken are in the best interests of the corporation. They must discharge their duties of skill and diligence, as well their duty of loyalty, including acting honestly and in good faith, not improperly delegating their responsibilities, and avoiding conflicts of interest.

LIABILITY FOR BREACH OF TRUSTEE DUTIES

Directors of charitable corporations have potentially higher exposure to personal liability than do directors of other not-for-profit corporations.

The recent decision in Ontario *(Public Guardian and Trustee) v. Aids Society for Children (Ontario)*[3] emphasizes the fiduciary responsibility of directors of charitable corporations as quasi-trustees. The court held that these fiduciary duties go beyond the mere furtherance of the charitable objects of the corporation. The case stipulates that although directors of a charity may not technically be trustees of charitable property, they *"are, to all intents and purposes, bound by the rules which affect trustees."*

Although a lower court decision, this case strongly argues that directors of a charitable corporation have an obligation to apply charitable property towards the charitable objects of the charity. This, in turn, requires that directors take pro-active steps to protect charitable property.[4] Any loss of charitable assets due to the inactivity or failure to act of the directors could make the directors liable for breach of their fiduciary duties, or possibly even breach of trust.

Liability risks from remuneration of directors

At common law, in Ontario at least,[5] directors of charitable corporations must not receive any direct or indirect remuneration or benefit from the charity on which they serve as directors unless court approval is first obtained. It is not settled law whether such a requirement applies in other jurisdictions.[6] This means that a director of a charitable corporation cannot be a paid employee, contractor, consultant or professional service provider of the charity, even if they are paid below fair market value for the services rendered or goods supplied. In such cases, both the director who received the remuneration and directors who authorized it would be at risk of personal liability.

Readers may note a potential conflict between this rule and section 98 of the *Canada Corporations Act* referred to earlier, which otherwise permits directors of not-for-profit corporations to declare a conflict of interest in a contract or proposed contract with the corporation and enables them to enter into a contract in which they have a personal interest. The prudent approach is to consider that the rule against paying remuneration to director of charitable corporations takes precedence over section 98.

The rule against remuneration does not apply to out-of-pocket expenses incurred by directors, such as mileage or other reasonable and related travel expenses. Directors may legitimately be reimbursed for these items.

In Ontario, the *Charities Accounting Act* (Ontario)[7] allows charities to follow a procedure to obtain consent from the Public Guardian and Trustee to permit directors of charitable corporations to receive remuneration. However, charities do not often use this option, and it is not clear which cases will receive the approval of the Office of the Public Guardian and Trustee.

In jurisdictions other than Ontario (except Québec), an application to court under trust law may be possible to permit remuneration. However, the availability of this remedy appears never to have been tested in a Canadian jurisdiction.

Liability for breach of trust when dealing with charitable property

Because their duties are akin to those of trustees, directors of charitable corporations may be held personally liable for breach of trust if they mismanage charitable assets. This means they can be personally responsible for the full amount of any loss to the charitable assets.

Breach of trust involving investment decisions

Directors of charitable corporations face considerable liability risks from the improper investment of charitable funds. Liability of directors in this regard may arise as a result of their failure:

- to determine and comply with the investment power in the letters patent or special act creating the charitable corporation;
- to determine and comply with specific investment powers contained in agreements accompanying a gift, such as a last will and testament of a donor in making a testamentary gift or a gift agreement by a donor in giving a perpetual endowment;
- to determine and comply with the applicable statutory investment power that applies in a particular province in relation to investments made in that province, typically found in provincial trust legislation;
- to invest in accordance with the standards of a prudent investor where the provisions of the trust legislation apply, including any mandatory investment criteria required by the Act;
- to develop and implement an investment plan as required by applicable trust legislation; and,
- to undertake investment decision making themselves, or in provinces that permit delegation of investment decision making, such as Ontario, to ensure that an appropriate agency agreement is in place appointing a qualified investment manager and that there is careful selection and monitoring of the investment manager chosen.

Liability risks to directors arising from investment of charitable property can be significant, as well as hard to protect against. Liability can range from losses arising from bad investments to liability for missed investment opportunities from overly conservative investment decisions.

EXAMPLE

In the face of an economic recession – i.e. two consecutive quarters of negative economic growth in the national economy – failure of trustees to review their investment portfolio could be considered to be putting the charitable assets unduly at risk. It is important to note, however, that this entails a two-part requirement: the directors are obligated both to look at whether the portfolio should change and to take a decision about what changes, if any, to make.

Liability risks from co-mingling of donor restricted funds

Donor restricted funds consist of gifts to a charity that are subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that constrain or limit a charity concerning how the gift can be used.[8] Donor restricted funds, also referred to as special charitable purpose trusts, can include:

- endowment funds, i.e., gifts of capital to be held and invested in perpetuity;
- donor restricted use, i.e., monies given to a building fund; and,
- ten year gifts, i.e., gifts of capital to be held for a minimum of ten years in accordance with the requirements of the *Income Tax Act*.

At common law, each donor restricted fund is required to be held in a separate account from other restricted trust funds and cannot be co-mingled. Few charitable corporations, though, comply with this common law prohibition against co-mingling restricted funds.

In Ontario, regulations have been enacted under the *Charities Accounting Act* to allow charities to co-mingle donor-restricted funds into a single account for investment purposes. However, restricted funds cannot be co-mingled with the general funds of a charity. In addition, there are numerous statutory requirements under the regulations of the *Charities Accounting Act* that must be complied with before donor-restricted funds can be co-mingled in Ontario.[9]

Co-mingling of donor-restricted funds in contravention of the regulations under the *Charities Accounting Act* in Ontario will expose directors to personal liability for breach of trust. Also, where legislation in other provinces does not permit co-mingling of restricted funds, directors of charitable corporations may face exposure to liability even if they comply with the regulations in Ontario.

Breach of trust involving charitable objects

Directors are obligated to apply charitable property in accordance with the corporate objects contained in the letters patent of the corporation. Failure to do so may expose directors to liability for breach of trust.

Breach of special purpose charitable trust involving donors

Directors may be held liable for breach of trust if they fail to apply funds in accordance with donors' restrictions or if they redirect funds given for one purpose, for example, a building fund, and use them for another purpose, for instance, to pay for general operating expenses. Breach of trust may also occur if there is a failure to hold and invest the capital of an endowment fund in perpetuity, unless the donor has authorized that encroachments can be made upon the capital of such a fund.

COMMON LAW LIABILITIES

Liability for lack of corporate authority

Directors acting outside the scope of their authority as defined by the letters patent, supplementary letters patent, or other governing documents of the corporation are personally responsible for any decisions or actions they take. This liability may arise owing to statutes, contracts, torts or the common law. Effectively, the directors are considered to have taken the decision(s) or action(s) as individuals rather than as a corporate body, so the 'corporate shield' does not apply.

STATUTORY LIABILITIES

Many provincial and federal statutes impose personal liability on directors of not-for-profit corporations. The most common of these relate to employees, reporting requirements, taxation and environmental regulations. Boards of directors should get legal advice to determine the precise scope of statutory liability affecting them. This will vary according to the activities of the corporation and the jurisdiction(s) in which it carries out those activities. This chapter focuses on some of the more common areas of statutory liability.

To whom does liability apply?

Most of the legislation imposing liability on directors does not actually define who is a 'director.' Individuals who are acting in the capacity of directors – de facto directors – but who may not have actually been elected as such may nonetheless be exposed to directors' liability. This could include those serving as de facto directors, *ex-officio* directors, those dubbed 'honorary' directors and those sitting on an executive committee or otherwise acting as part of a group managing the corporation's affairs, no matter what it is called. If these individuals act like directors, they can attract the liability of directors.

Can directors avoid liability by resigning?

Resigning as a director does not affect a director's exposure to liability for actions or omissions while in office. However, resignation will limit the potential for liability after the date of resignation and will also start the limitation period running. Most of the legislation contains limitation periods which provide, for example, that no action can be commenced against a director more than a specified number of years after he or she ceased to be a director of the corporation.

Director liability under the <u>Canada Corporations</u> <u>Act</u>

The *Canada Corporations Act,*[10] under which all federal not-for-profit corporations are incorporated (other than those established by special act of the Parliament of Canada), contains a range of duties and statutory liabilities for directors. Many provincial incorporation statutes provide for similar liability. Provincially incorporated not-for-profits will need to determine the particular requirements that apply to them.

Directors should be particularly alert to liability relating to four areas:

- government reporting requirements;
- proper identification of the corporation;
- membership list disclosure provisions; and,
- winding-up procedures.

Reporting requirements

Failure to file the required information with Industry Canada can lead to personal liability for directors. There is no limitation or possible defence for a director who permits or acquiesces in permitting a breach to occur. The relevant provisions are as follows:

- Section 133 creates an obligation on corporations to file an annual summary on or before June 1st in each year containing information effective as of the immediately preceding March 31st. The information required in the annual summary is listed in subsection 133(1) and the form must be signed by a director or officer of the corporation. Section 133(3) provides that a corporation that defaults in filing an annual summary is guilty of an offence and is liable on summary conviction to a fine of not less than twenty dollars and not more than one hundred dollars for each day that the default continues and every director or officer who "…knowingly authorized, permitted or acquiesced in any such default is guilty of an offence and is liable on summary conviction to a like fine."
- Subsection 150(2) provides in part that if all or some of the directors are aware of the corporation's default or failure to comply with the provisions of Section 133 (filing of annual returns), a court may hold the directors personally liable for costs incurred in the winding-up of the corporation pursuant to a court order under the *Winding-Up and Restructuring Act*.
- Section 114.2(5) of the *Canada Corporations Act* provides that if a corporation or officer is required to file any report, return, bylaw or other document with Industry Canada and the corporation or officer defaults in its filing, the Minister may require the corporation or officer to make a report upon any subject connected with its default and any director or officer who knowingly authorizes or permits a default in providing such report is guilty of an offence and may be liable for a penalty of up to $50 per day while such default continues.

Identification of the corporation

Directors have an obligation to ensure against flawed or incomplete identification of the corporation on business documents and in representations to outside parties. Section 27 of the *Canada Corporations Act* creates an offence dealing with this and also imposes personal liability on directors in some situations.[11]

The penalty imposed on directors for failing to comply with Section 27 is stated to be two hundred dollars, but the director is also personally liable to the holder of any such bill of exchange, promissory note, endorsement, cheque, or order for money or goods, for the full amount, if the same is not paid by the corporation.

Membership lists

Most governing statutes contain provisions which allow members, and sometimes others, to obtain a membership list containing the names and respective addresses of the members of the corporation. Section 111.1 of the *Canada Corporations Act* contains the requirements for obtaining such a list and also makes directors personally liable in the following instances:

(a) where the corporation fails to furnish a membership list when properly requested to do so, subsection 111.1(1) provides that every director and officer who "…knowingly authorized, permitted or acquiesced" while in the office is guilty of an offence and is liable on summary conviction to a fine of up to $1,000.00 or six months imprisonment or both;

(b) subsection 111.1(3) makes it an offence to use a membership list for any of the prohibited purposes listed under the section and together with the corporation, every director or officer who "...knowingly authorized, permitted or acquiesced" while in the office is guilty of an offence and is liable on summary conviction to a fine of up to $1,000.00 or six months imprisonment or both;

(c) subsection 111.1(5) provides that every person who offers for sale, purchases or otherwise traffics in membership lists or copies of such lists is guilty of an offence and every director or officer who "...knowingly authorized, permitted or acquiesced" is also guilty of an offence and liable on summary conviction to a fine of up to $1,000.00 or up to six months imprisonment or both.

Liability on winding-up

The *Canada Corporations Act* imposes liability on directors where, upon the application of the Attorney-General of Canada to a court, the corporation is wound up and dissolved under the federal *Winding-up and Restructuring Act*.[12] A corporation may be wound up in this manner under section 5.6 of the *Canada Corporations Act* if the corporation has been operating outside of its letters patent (either outside of its corporate objects or powers). Upon an application to the court for an order winding up the corporation, the court may determine whether the costs of the winding up shall be borne by the corporation or personally by the directors who participated or acquiesced in the offence.

Similarly, under section 150 of the *Canada Corporations Act*, upon application of the Attorney-General of Canada, a not-for-profit corporation may be wound up if it:

(a) fails to hold an annual meeting of members for two consecutive years; or

(b) fails to file an annual return for six months or more.

Subsection 150(2) provides that upon an application to the court for an order winding up the corporation, the court may determine whether the costs of the winding up shall be borne by the corporation or personally by any or all directors who were knowingly responsible for the corporation's failure or default.

General offence provision

The *Canada Corporations Act* contains a general offence provision for the breach of any of the sections of the legislation for which no express penalty has been prescribed. Section 149 of the *Canada Corporations Act* provides that a director, manager or officer will be liable, on summary conviction, to a fine of not more than $1,000, or to imprisonment for not more than one year, or both, for doing anything contrary to the legislation or for failing to comply with any requirement in the legislation.

Other statutory offences under the Canada Corporations Act

In addition to those described above, directors should be aware of the following offences and penalties that apply to directors under the *Canada Corporations Act*: section 71 - Omission from Register of Mortgages, section 72 – Refusal of Inspection (mortgages), section 98 – Interest of Director in a Contract where no Declaration and section 99 – Employees.

Since liability with respect to employees is one of the most common areas of potential liability, this area will be reviewed separately below.

Director liability under other federal and provincial statutes

The statutory laws that apply to a given not-for-profit corporation depend on the activities it carries on in meeting its mandate. For instance, a nursery school carrying on activities in Ontario is subject to the requirements of the *Day Nurseries Act.*[13] In order to determine the scope of their liability, directors need to be knowledgeable about the legislation that applies to the corporation's activities and programs.

However, some statutory provisions apply across the board to most business corporations and not-for-profit corporations. These relate to employees, taxation and environmental regulations.

Employees

WAGES

Under most circumstances, the employment legislation governing not-for-profit corporations will be provincial. However, corporations operating within areas of federal jurisdiction – such as airport authorities – will be subject to federal statutes and regulation. Typically, directors can be personally liable for up to six months of unpaid wages and vacation pay owed to employees. This only applies, however, to services performed during the period that one served as a director, and may be subject to other limitations. For instance, in Ontario, a director is not liable unless:

- the corporation has been sued for the debt within six months after it became due and the employees have been unable to collect from the corporation;

  or
- the corporation has gone into liquidation, been wound up or declared bankruptcy.

Directors must be sued for the debt while they are still directors or within one year after they ceased being directors.[14]

In Québec, the *Companies Act* does not hold directors of not-for-profit corporations liable for the unpaid wages of their employees.

Source deductions

FAILURE TO REMIT FEDERAL TAXES

Directors must ensure that proper deductions are made on staff salaries and other remuneration paid to employees. Under the *Income Tax Act,*[15] directors who were in office at the time that the corporation failed to deduct, withhold or remit or pay the amount due are liable, together with the corporation, for the amount and any interest or penalties.

If a director can show that he or she exercised the degree of care, diligence and skill to prevent the failure to deduct source deductions that a reasonably prudent person would have exercised in comparable circumstances, he or she may not be found liable.[16] Therefore, directors should take positive action to ensure that controls are in place, such as establishing a payroll trust account and requiring the treasurer or CEO to report on a regular basis to the board that all required remittances have been made to the government.

Directors should also ensure that the corporation treats those who provide services to it as employees where the law requires. This is particularly important when dealing with independent contractors. If an independent contractor is found to be, in fact, an employee, the directors may be liable under the *Income Tax Act.* In a number of cases, the courts have found not-for-profit organizations liable for unpaid source deductions, plus interest and penalties, for employees whom the organizations improperly characterized as independent contractors.[17] Where the corporation is unable to meet this obligation, directors may be personally liable for amounts owing.

Failure to remit Employment Insurance premiums and Canada Pension Plan contributions

Every employer paying remuneration to a person employed in insurable employment must deduct and remit to the Receiver General insurance premiums as prescribed by the *Employment Insurance Act*[18] and Canada Pension Plan Contributions as prescribed by the *Canada Pension Plan Act.* Failure to do so could result in personal liability for directors.

The *Employer Health Tax Act* establishes a health tax payable by employers carrying on business or programs in Ontario. Directors and officers who directed, authorized, assented to, acquiesced in or participated in the commission of an offence by the corporation under this Act are themselves guilty of an offence and are liable to the punishment provided for the offence.[19] Similar provisions may apply with regard to payment of health insurance premiums or a dedicated health tax in other provinces.

Other employee related liability

Depending on the activities of the corporation, directors may also be exposed to personal liability under the *Canada Labour Code*[20] and provincial pension benefits/standards legislation, pay equity legislation, occupational health and safety legislation and workplace safety legislation.

Taxation

Income Tax Act

Registered charities and not-for-profit corporations are exempt from tax under Part I of the *Income Tax Act*. However, they are not exempt from the reporting and compliance requirements set out in the Act. The penalties for failure to abide by these provisions are steep. A registered charity could lose its charitable status or directors and officers could be liable for criminal sanctions.

Excise Tax Act

Not-for-profit corporations are generally required to pay GST on most goods and services (and certain charities and not-for-profit corporations are entitled to some rebate of GST paid by them). Not-for-profit corporations may also be required to collect and remit GST on goods and services provided by them to the public.

One of the most common mistakes made by not-for-profit corporations is failing to collect and remit GST on membership dues or sales of items to members or clients. Whether or not GST is payable depends in part on whether members receive a material benefit as a result of their membership. Mere entitlement to receive a newsletter or other fringe benefit is not sufficient to make memberships subject to GST.

In some circumstances, the *Excise Tax Act*[21] imposes liability on the corporation and its directors personally for GST remittances. Such personal liability only arises, however, if certain steps – relating to registering and proving the debt and corporate dissolution or bankruptcy being underway [22] – have been taken.

In addition, directors have a due diligence defence similar to the one under section 227 of the

Income Tax Act. Subsection 323(3) of the *Excise Tax Act* provides that a director is not liable for GST amounts due where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. Also, liability for any assessment of amounts payable by a person who is a director of a corporation expires within two years after the person ceases to be a director.

Environment

Directors and officers of not-for-profit corporations are subject to the same liability under the environmental protection legislation as are directors and officers of business corporations. While the legislation may not apply to most not-for-profit corporations, depending on their nature and the location of their activities and programs, it may be an area worth considering in more depth. In many cases, the potential liabilities contemplated under environmental statutes are far-reaching and quite onerous. So, for instance, if a not-for-profit corporation is offered a gift of real property, legal counsel should review whether contaminants already exist in the property.

The *Canadian Environmental Protection Act, 1999* [23] imposes obligations on directors with respect to air and water pollution and the proper storage and disposal of toxic substances. It says that directors and officers have a positive duty to ensure that the corporation complies with the Act and related regulations. Failure to comply can result in prison terms and fines of up to $1 million. The *Ontario Environmental Protection Act* [24] requires directors to take reasonable care to prevent the unlawful discharge of a contaminant into the natural environment.

Statutory liability risks of directors of charities

In addition to the statutory liabilities that apply to all not-for-profit corporations, directors of charitable corporations are subject to statutory liabilities that are only applicable to charities. Some of the more important of these are:

STATUTORY LIABILITY FOR REGISTERED CHARITIES UNDER INCOME TAX ACT (CANADA)

Directors of charitable corporations can face personal liability if the corporation does not comply with mandatory requirements under the *Income Tax Act* concerning the charity's operations, reporting requirements, the disbursement of funds and the receipting of donations.

STATUTORY LIABILITY FOR CHARITIES UNDER THE CHARITIES ACCOUNTING ACT (ONTARIO)

Directors of charitable corporations that operate in Ontario face additional liability under the *Charities Accounting Act* (Ontario). This legislation gives certain statutory rights to donors and to the Public Guardian and Trustee that allow directors to be called to account for the improper use of charitable property.

Section 6 of the *Charities Accounting Act* (Ontario) allows a donor to make a complaint about the fundraising practices of a charitable corporation. The donor needs only to deliver a written complaint to a judge of the Ontario Superior Court of Justice, who may then order an investigation by the Public Guardian and Trustee. This does not apply to 'religious' or 'fraternal' organizations.

Charities Accounting Act (Ontario) (section 4) provides penalties to a charity and its directors if they do not abide by specific directions about a donation made by a testator in a will or by a donor in a gift agreement. The Public Guardian and Trustee can bring the matter to court, either on its own initiative or as a result of a complaint received from a donor. It can ask the court to require the charity to comply with the terms of the directions given by the donor, and to impose a penalty on the charity or even imprisonment of its directors. It can also ask that the charity be removed as the trustee of the directed fund and that a new trustee be appointed.

Liability risks from fundraising

A charitable corporation and its board of directors must comply with a number of statutes affecting charitable fundraising. Failure to do so could expose the directors to personal liability. While it is beyond the scope of this chapter to provide anything more than a cursory overview of the applicable statutes, some of the more important of these are:

Specific charitable statutes concerning fundraising

- *Income Tax Act* (Canada)
- *Charities Accounting Act* (Ontario)
- *Charitable Gifts Act* (Ontario)[25]
- *Religious Organizations' Lands Act* (Ontario)[26]
- *Charitable Fund-Raising Act* (Alberta)[27]
- *Charities Endorsement Act* (Manitoba)[28]
- *Charities Act* (Prince Edward Island)[29]

General statutes affecting charitable fundraising

- *Competition Act* (Canada)[30]
- *Privacy Act* (Canada),[31] and any provincial privacy legislation
- provincial insurance legislation, such as the *Insurance Act* (Ontario)[32]
- provincial loan and trust corporation legislation, such as the *Loan and Trust Corporations Act* (Ontario)[33]
- provincial securities legislation, such as the *Securities Act* (Ontario)[34]
- provincial trustee legislation, such as the *Trustee Act* (Ontario)

Anti-Terrorism Legislation

The *Anti-terrorism Act* (Canada),[35] formerly Bill C-36, enacted in December 2001, and related federal legislation, has created new and serious liability risks for charitable corporations and in some instances their directors. These range from seizure of charitable property, loss of charitable status, to Criminal *Code* [36] charges against the charity, its directors and even donors for fundraising that directly or indirectly supports or facilitates broadly defined 'terrorist activities' or 'terrorist groups.'

As a result of the breadth of application of the *Anti-terrorism Act* (Canada) and the serious consequences which flow from it, directors of charitable corporations must now be extremely diligent in ensuring that they do not contravene the many criminal and civil law offences under the Act and related federal legislation.[37]

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Sample questions for prospective or curent directors to ask the organization

1) Do the organization's current activities reflect its corporate objectives as set out in its incorporating documents?
2) Does the corporation carry out its obligations under the corporate bylaws, such as the requirement to call an annual general meeting?
3) Does the board have a process for authorizing contracts entered into by the corporation?
4) Is the corporation fulfilling all of its statutory obligations, such as filing mandatory reports with the appropriate government bodies and making the proper source deductions for employees?
5) If the corporation is a registered charity, is it taking precautions to ensure the proper investment of charitable funds?
6) If the corporation is a registered charity, is it complying with applicable laws regulating its fundraising activities?

Sample questions for directors to ask themselves

1) When I am unable to attend a board meeting, do I read the minutes of the meeting and voice any concerns I may have?
2) Do I voice my opposition to matters that I disagree with and make sure that my objections are recorded in the minutes of the meeting?
3) Have I read and understood the corporation's constitution or letters patent and bylaws?
4) Do I understand all of the corporation's legal obligations?
5) If I am a director of a charitable corporation, do I understand the special legal liabilities that both I and the corporation face?

LIABILITY CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Awareness of liability arising from acting beyond the corporation's authority	Director, in consultation with board colleagues and/or executive director	Annually	Does the director know the scope of the corporation's mandate, as defined by its corporate documents, and that the corporation is required to restrict its activities to that mandate?
2. Awareness of contractual liability	Director, in consultation with board colleagues and/or executive director	Annually	Do corporate documents provide for authority to sign contracts? Does the director know in what specific ways personal liability may arise?
3. Awareness of liability in tort	Director, in consultation with board colleagues and/or executive director	Annually	Does the director know in what specific ways personal liability may arise for claims of injurious conduct? Does he or she know that negligent mismanagement can result in claims?
4. Awareness of liability arising from common law duties	Director, in consultation with board colleagues and/or executive director	Annually	Does the director know that he or she is liable to the corporation for losses suffered as a result of failure to meet his or her 'fiduciary duties'? Does the director understand the scope of these fiduciary duties?

5. Awareness of liability arising from statute	Director, in consultation with board colleagues and/or executive director	Annually	Does the director know that, under certain statutes, personal liability of directors may arise?
6. Statutory liability relating to incorporating legislation (including filings), wages, taxes – income, goods & services, sales, source deductions, employment, environmental protection	Director, in consultation with board colleagues and/or executive director	Annually	Does the director know and understand the requirements stemming from each of these issues, and the obligation on directors to ensure that these requirements are met?
7. Assessment of statutory liability arising from the specific mandate or activities of the corporation	Full board	Every two years, or more frequently if the regulatory environment is changing rapidly	Has a review been prepared, either internally or though seeking external legal advice, identifying regulatory requirements that the corporation is required to meet?

4

Rights and Powers

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INTRODUCTION

Generally, the rights and powers of directors of a not-for-profit corporation are found in the legislation governing its incorporation, which in the case of a federal corporation is the *Canada Corporations Act*[1], in the corporation's letters patent and, to a limited degree, in the common law. The federal Corporations Directorate Policy Summary on Not-for-Profit Corporations[2] (Policy Summary) provides a general guideline that directors of federal not-for-profit corporations can use to review their rights and powers.

DIRECTORS' RIGHTS

Management access

The board of directors is responsible for the effective management of the affairs of the not-for-profit corporation. In fact, the Policy Summary provides that the bylaws of a federal not-for-profit corporation must state explicitly that the board has this power, although they may also specifically exclude certain powers that are instead to be exercised by the membership of the corporation. The power to manage the corporation involves:

- ensuring that the objects of the corporation are properly carried out;
- setting long-range objectives and strategic plans for the corporation;
- being responsible for all aspects of the corporation's operations;
- ensuring the corporation's financial stability and overall performance; and,
- supervising management and staff.

Each individual director of a not-for-profit corpora-

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tion is also responsible for his or her own acts and omissions while in office. The board of directors must, therefore, have unimpaired access to all the resources of the corporation as necessary in order to effectively perform their management duties.

Books and records

A federal not-for-profit corporation is required to keep a book, or books, that records all the constitutional (otherwise known as 'constating') documents of the corporation, as well as the names, addresses and occupations of all members and directors of the corporation.[3] It must also keep proper books of account and accounting records of all financial matters and other transactions of the corporation.[4] Failure to do so is an offense under the *Canada Corporations Act*.

The *Income Tax Act* (Canada) [5] requires charitable corporations to keep certain records and books of account, duplicates of all charitable receipts issued for donations by the charitable corporation, and information that verifies donations made to the charitable corporation.[6]

Because of these statutory requirements, a director of a federal not-for-profit corporation has the right at any reasonable time to inspect and copy all the books, records, and documents (not only those that are publicly available) and to inspect the physical property owned or used by the corporation. This allows directors to exercise their managerial and administrative powers, make informed decisions about the affairs of the corporation, confirm that the corporation is in compliance with all applicable laws, and ensure that any funds collected from the public by the corporation in trust are used only for the designated purposes.

Notice of meetings

Meetings of the board of directors of a not-for-profit corporation are an essential way for directors to exercise their power to manage and administer the affairs of the corporation. Therefore, each director has a right to receive proper advance notice of all board meetings.

Federal not-for-profit corporations must include provisions in their bylaws that address how the corporation will hold its meetings.[7] Generally, the bylaws must establish either a specific amount of time that is reasonable for notice of directors' meetings or must indicate that reasonable notice will be given. While a specific time period is not outlined in the *Canada Corporations Act*, the Policy Statement recommends a minimum of 14 days for notices sent to directors by mail. The bylaws may also permit notice of directors' meetings to be sent by electronic means, including e-mail or facsimile, or notice to be waived by directors who attend the board meeting.

If a director is not able to attend a meeting of the board of directors, he or she has the right to review the minutes of such a meeting and any financial statements presented, and may voice an objection to any information these contain.

The right to attend meetings is subject to directors' fiduciary duty to avoid any conflict of interest. In some circumstances, conflict of interest issues will preclude the director from being present for discussions and votes on particular matters; occasionally, where curing the conflict requires that the director resign, the right to attend meetings will be lost. In such situations, other directors need to be wary of the former director's continuing presence at meetings even as a guest, as this may give rise to an opportunity to improperly influence decisions. Where a director is absent temporarily, owing to a conflict of interest issue, this absence should be carefully recorded in the minutes. (Please see Chapters 2 and 6 for more information on conflicts of interest.)

Right to vote

All directors of a federal not-for-profit corporation, except *ex-officio* and honourary directors, have the right to vote at meetings of the board of directors. The bylaws of the corporation may also, however, give *ex-officio* and honourary directors the right to vote. However, where the bylaws of the corporation provide voting rights to directors, such voting rights must be equal for all voting directors. This means that such directors may not be given either votes that are weighted differently than other votes (for instance, double or half votes) or the right to vote only on certain specified matters (for instance, giving an honourary treasurer a vote only on financial matters).

While the right to vote is a basic right, it is subject to directors' fiduciary duty to avoid any conflict of interest in any contract or proposed contract of the corporation. (Please see Chapters 2 and 6 for more information of this duty.)

Minutes

A federal not-for-profit corporation must keep minutes of all meetings of its members, directors and the executive committee.[8] Directors have the right to vote on the approval of the minutes of all previous meetings of the board of directors and to voice any objections to them.

Directors also have a right to inspect the minutes of all meetings as part of their right to access and inspect the corporation's books and records. If the corporation has established committees, the board of directors has the right to receive copies of the minutes of each committee's meetings. This allows directors to fulfill their responsibility to exercise overall management of the corporation.

DIRECTORS' POWERS

Generally, the powers of directors of a federal not-for-profit corporation are set out in its letters patent. Directors should carefully review the letters patent of the corporation on which they serve as a board member. They should also refer to the *Canada Corporations Act*, which sets out the standard powers of a federal not-for-profit corporation.

Power to manage the affairs of the corporation

The board of directors of a federal not-for-profit corporation has the power to manage the affairs of the corporation. In all provinces except Québec, directors of a charitable corporation have an additional trustee-like duty imposed on them by common law and must manage and account for the assets of the corporation in a manner akin to that of a trustee. As such, directors of charities are considered to have a higher fiduciary position in relation to the assets of the corporation and a higher duty of care than directors of either other not-for-profit corporations or for-profit corporations. This means that they have the same powers as directors of other not-for-profit corporations but must exercise such powers with somewhat greater care than their not-for-profit counterparts. As it is a civil law jurisdiction, this additional trustee-like common law duty does not apply in Québec.

Standard powers provided by statute

The *Canada Corporations Act* (Section 16) outlines all of the standard powers of a federal corporation. Legally, these are known as incidental and ancillary powers. The most important are:

- the power to purchase or acquire assets or properties in order to carry out the purposes of the corporation (e.g., buying equipment or furniture for the organization's work or to carry out its functions);
- the power to apply for, purchase or acquire any intellectual property that may be used for the corporation's purposes, and to sue, exercise, develop or grant licenses relating to this intellectual property (e.g., to buy or create, use and protect trademarks or copyright materials);
- the power to amalgamate or enter into partnerships or other arrangements with any other company, firm or person carrying on business or transactions that the corporation is authorized to carry on (e.g., contracting or establishing joint ventures to achieve the corporation's goals);
- the power to enter into any arrangements with any government or authority that are conducive to the corporation's objects in order to obtain rights, privileges and concessions (e.g., entering into fee-for-service arrangements with government to achieve the corporation's goals);
- the power to purchase, lease, acquire, sell or otherwise deal with any real or personal property (e.g., renting or purchasing office space);
- the power to apply for and secure, and to exercise and carry out any power, right or privilege that any government or authority or any corporation or other public body may be empowered to grant, and to pay for, aid in and contribute towards carrying the same into effect (e.g., the right to be licensed or accredited by a government body for a particular purpose, or the right to appear before an administrative tribunal);
- the power to invest and deal with the monies of the corporation (e.g., buying term deposits with the corporation's cash funds); and,
- the power to do all such other things as are incidental or conducive to the attainment of the objects and the exercise of the powers of the company (e.g., expanding services to a broader group or different geographical area in keeping with the corporation's mandate).

Federal not-for-profit corporations may also be subject to special statutory requirements in the different jurisdictions in which they operate. So these standard powers may be limited by provincial legislation. For instance, under the *Charities Accounting Act,* (Ontario) [9] charitable corporations in that province are not allowed to hold surplus land in Ontario for longer than three years.

Power to borrow money

The *Canada Corporations Act* (Section 65(1)) gives statutory borrowing powers to directors of a federal not-for-profit corporation. Directors must first pass a special borrowing bylaw. They must then hold a special meeting of the general membership of the corporation to allow members to vote on the bylaw. The bylaw goes into effect only if it is sanctioned by at least two-thirds of the votes cast at this special meeting of members.

Statutory borrowing powers permit the directors of the corporation to:

- borrow money upon the credit of the corporation;
- limit or increase the amount to be borrowed;
- issue debentures or other securities of the corporation;
- pledge or sell such debentures or securities; and,
- secure such debentures, securities or borrowing by mortgage, hypothec, charge or pledge of real and personal property.

Under the *Canada Corporations Act*, not-for-profit corporations are able to borrow funds in much the same manner as business corporations. The *Income Tax Act*, however, applies some limitations to this power for charitable corporations.

For instance, charitable foundations are only allowed to borrow if they do not incur debt for anything except current operating expenses, the purchase and sale of investments, and the administering of charitable activities.[10] If they do, this could be a basis for de-registration as a registered charity under the *Income Tax Act.* In addition, directors must ensure that any security given for a loan by the corporation is the beneficial property of the corporation (i.e., owned for the benefit of the corporation) and not trust property (held for the benefit of a particular party or purpose), such as an endowment held by a charitable corporation.

Directors of a federal not-for-profit corporation have the power to delegate borrowing powers to other officers or directors if authorized by bylaw.[11] They must, however, closely monitor the borrowing process and how the money borrowed is being spent.

Power to invest

Directors of a federal not-for-profit corporation have the power to make investments. The *Canada Corporations Act* (Section 16) grants federal not-for-profit corporations the power "to invest and deal with the monies of the corporation not immediately required in such manner as from time to time may be determined." The letters patent of the corporation may also contain specific provisions that override or supplement this power. Directors have a common law duty to invest special purpose funds for their specific purposes. This means that they have the power to deny requests or demands by donors or other parties to divert such funds for any other purposes.

If a federal not-for-profit corporation holds property in trust, such as an employee benefit fund, provincial legislation may include provisions that mandate the corporation's investment power over these assets. Such provisions may also apply to not-for-profit corporations that are registered charities.

EXAMPLE

The *Trustee Act* in Ontario says that directors of a charitable corporation have the power and duty to invest the assets of the corporation as a prudent investor would. This includes the power to invest in mutual funds and to delegate investment decision making to qualified investment managers. Directors must, however, comply with certain statutory requirements, such as mandatory investment criteria, establishing and complying with an investment plan, and ensuring that a written agency agreement is entered into between the corporation and the qualified investment manager appointed by the board of directors.

Investment powers are not uniform in various Canadian provinces. It is therefore important that a not-for-profit corporation carefully determine what investment powers apply in the jurisdiction in which it is investing the funds.

Power to dispose of property

Directors of a federal not-for-profit corporation have the power to sell, lease, exchange, mortgage or otherwise dispose of any property of the corporation. This is subject to any restrictions that may be included in a trust document or agreement establishing a gift to a charitable not-for-profit corporation, such as a ten-year gift agreement. Directors of a not-for-profit corporation, particularly a charitable corporation, need to determine the nature of the property being disposed of and whether any restrictions may apply.

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SAMPLE QUESTIONS FOR PROSPECTIVE DIRECTORS TO ASK THE ORGANIZATION

1) Do I understand all the rights and powers associated with the office of director?

2) Does the corporation have procedures or measures that will assist me if exercise those rights and powers?

SAMPLE QUESTIONS FOR DIRECTORS TO ASK THEMSELVES

1) Am I aware of and exercising the full range of my rights and powers?

2) Should I be seeking any logistical assistance from the organization to facilitate the exercise of my rights and powers (e.g., better access to books, records, etc.)?

3) Should I be seeking any procedural assistance from the board or board officers to facilitate the exercise of my rights and powers (e.g., more meeting notice)?

RIGHTS AND POWERS CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Management powers	Full board	Annually	Review whether bylaws set out powers, and note any exclusions that reserve powers to the members.
2. Books and records	Chair, audit committee, or other individual or committee designated by the board	Annually, typically in conjunction with the audit if there is external review of corporation's finances	Verify availability of corporate books and records.
3. Meeting procedure	Full board	Annually	Annually Is meeting notice adequate? Are directors aware of any restrictions on voting rights? Are minutes prepared and distributed regularly?
4. Standard powers	Full board	At time of decision	Is there proper authority to undertake this action, either through standard powers or through board powers provided elsewhere?
5. Borrowing	Full board	At time of decision on transaction	Is there proper authority to enter into the transaction? Does the nature of the corporation or type of asset used as collateral raise any additional concerns (e.g., is there a trust involved?)
6. Investment	Full board	At time of decision on transaction	Is there proper authority to enter into the transaction? Does the nature of the corporation or type of asset used as collateral raise any additional concerns (e.g., is there a trust involved?)

5

Committees

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INTRODUCTION

Committees are an essential tool for the effective and efficient functioning of a not-for-profit corporation's board of directors. An appropriate committee structure allows a board to focus expertise where it can best be used, and manage the flow of information so directors are not burdened with unnecessary material that can hinder rather than facilitate good decision making. Solid committee work – i.e., thoughtful assessment of information that results in well-focussed recommendations or options – is a lynchpin of prudent and informed board decisions.

There is no magic formula for determining the best division of responsibilities among the board as a whole and any committees it may have. The mandate, size and the stage of development of the organization will largely dictate its committee structure. In some cases, the committees that are struck will be determined by the organization's governance model. Some models require establishment of an executive committee, standing audit committee and/or nominating committee. In other cases, committees are set up to meet operational needs of the board or the organization. For instance, the board may strike a committee to help it deal with a major issue or a specific problem – such as a board conflict of interest policy or organizational membership policy.

The responsibilities of a specific committee may vary from organization to organization, depending on its reliance on volunteers. For instance, the fundraising committee in an organization run solely by volunteers may be responsible for preparing funding applications. In an organization with some paid staff, a similar committee may play more of a supporting role – researching and identifying potential funders – while staff prepares the applications. In organizations with highly professional staff, the fundraising committee's role may be limited to considering policy and addressing questions like where

* B.A., LL.B. The Canadian Centre for Philanthropy (www.ccp.ca), is a national, voluntary sector umbrella organization.

and how funding efforts should be focused.

Good co-ordination is needed between the board (typically through the chair) and the Executive director in determining the proper committee structure, particularly in regard to striking of committees dealing with operations. This will help avoid situations where the board creates a committee to carry out a function that is more appropriate to staff. Mandating a board level committee relating to an operational matter, especially when that mandate is entrenched in the bylaws, can sometimes be at cross-purposes with staff effectively handling the issue and can also result in resources being devoted to the board committee that might better be used elsewhere.

Committee terms of reference should always provide for, at a minimum, the following elements:

- chair (how selected);
- composition (size and how selected);
- reporting responsibility (to whom and when);
- mandate (scope of authority);
- nature of authority (report, recommend, act); and,
- resource and/or staff support.

Adequate insurance coverage should always be in place to protect committee members – including those who are not board members – from any liability that may arise from *bona fide* committee decisions or actions. Indemnification provisions in the articles of incorporation or bylaws should also contemplate protection against actions arising from committee work.

TYPES OF COMMITTEES

Special Committees

These are short-term committees stuck to deal with, or make recommendations on, a specific governance or organizational issue. Members of the committee do not have to be members of the organization or the appointing board.

Among the special committees typically struck by not-for-profit corporations are: personnel/ human resources, fundraising, and programming committees. Less frequently considered, but worth contemplating, are communications, compensation and volunteer committees.

The mandate of a special committee is determined by the board resolution that establishes it. The resolution should also cover the size of the committee, either as an absolute number or as a permissible range; the selection procedure; and the scope of any power delegated to the committee.

In some cases, the scope of the committee's power may be set out or amended in a separate resolution – for instance, where the committee's mandate evolves over time, or where an aspect of the committee's work was not contemplated when it was established.

Committees that are appointed "with power" have sufficient powers to carry out their instructions. Under the Québec *Companies Act*, only the executive committee can be appointed "with power". In that province, all other committees are advisory.

Federally, and in some other jurisdictions, committees may be appointed with more limited authority – for instance, to represent the board in certain specific dealings, to act as agents for a specific purpose, or to bind the corporation in a particular transaction.

EXAMPLE

A committee may be mandated to make recommendations only, or it may be mandated with decision-making power with respect to a certain matter or matters. An organization may need to buy or erect new offices. Its board may strike a building committee mandated to do anything from researching and recommending lease or purchase to choosing an appropriate site and selecting an architect to overseeing construction of the new facilities.

The amount of power delegated to the committee will turn on its size and expertise in comparison to the full board, the scope of the project, and ensuring a proper balance is stuck between efficiency and accountability in the decision-making process.

Committees, like directors, face certain limitations on their powers. A board can never do indirectly through a committee something that it is not empowered to do as a board. So, for instance, a committee may not act outside the mandate of the organization as established by its objects. Committee members drawn from outside the board of directors are subject to these same limitations.

Advisory committees have no power to act on behalf of the corporation. Such committees are sometimes established to give an organization credibility or as a tool for fundraising. Sometimes they are struck to create a pool of technical expertise from which staff may draw in carrying out the organization's activities.

Committee members should have a clear understanding of their powers and be mindful how they present the committee to those outside the organization. In some cases, potential liability can arise when third parties rely on authority they believe a committee has, but which it does not in fact possess.

Where members of an advisory committee are expected to give professional or technical advice to staff, either as a group or individually, care should be taken to ensure that either the advisors or the corporation carry adequate insurance to protect against any claims that may arise from the advice.

In not-for-profit corporations where committees play an active role in organizational decision making, special care should be given to structure committees so that staff do not have to answer to two authorities. In practice, this means that committee mandates should not mirror the job descriptions of staff. When a committee's mandate closely parallels a staff member's responsibilities, the staff member may get direction from the committee that is at cross-purposes with instructions received from a supervisor or the full board. Staff should always report either to another staff person or to the full board, not to a committee.

Standing Committees

These are permanent committees stuck to deal with, or make recommendations on, on-going governance or organizational issues. Members of a standing committee do not have to be members of the organization or the appointing board.

The mandate of a special committee may be determined either through a provision in the organization's bylaws or in the board resolution that establishes it. Standing committees differ from special committees in that their decisions or actions are an integral part of the board's work. As such, it is advisable to set out in the bylaws how these committees are constituted. Industry Canada's Policy Summary on Not-for-Profit Corporations, which applies to federally incorporated corporations, states:

Where the bylaws provide for standing committees, they must also provide:

1) The manner of appointment or election of committee members.

2) The manner in which committee members are removed.

3) The responsibilities or duties of committee members.

4) The remuneration of committee members.[1]

Standing committees do not have to be set out in the bylaws. If they are not, then, at a minimum, these four provisions and the committee size (either as an absolute number or as a permissible range) should be contained the board resolution establishing the committee and recorded in the minutes of the meeting at which the resolution was passed. The scope of the power delegated to the committee should also be set out in the resolution. If the scope of the committee's power is set out in the bylaws, it cannot be amended through a board resolution.

Two standing committees that are common in not-for-profit corporations are the nominating committee and the audit committee.

Nominating committee

This committee oversees the process of board recruitment and deals with removal or replacement of directors. Although a nominating committee is not required by law, it is a key element of good governance for not-for-profit corporations. The nominating committee's role may be limited to finding candidates for the board, or may extend to determining appropriate nominees for particular positions on the board. It may also perform a disciplinary or advisory function: dealing with directors who are remiss in their duties or suggesting roles and parameters of directors' work.

Inclusion of a wide range of stakeholders in the governance process is the norm in many not-for-profit corporations. In these cases, the nominating committee can play a decisive role in ensuring that all interests are balanced and that the composition of the board fosters decision making that is in the best interests of the corporation as a whole.

Care should be taken to ensure that nominating committee members are disinterested – i.e., that they have no close ties to either staff or particular factions on the board. Perhaps more than any other committee, the nominating committee needs to be concerned with the long-term interests of the corporation. For this reason, it is important that it act independently. Unless the committee is seen as independent, its ability to deal with or remove delinquent directors may be compromised.

Audit Committee

This committee's key function is as liaison between the auditor and corporation's financial manager. Depending on how professional the not-for-profit corporation's staff are and how extensive the corporation's operations are, the mandate of the audit committee may be largely limited to the annual financial review or may extend to closer supervision of accounting practices.

In some cases (typically in small member-benefit organizations), an independent external assessment of the finances of a not-for-profit corporation is not legally required. The board should assess how active the committee needs to be in these circumstances to properly oversee the financial integrity of the corporation. Such factors as the size of the budget, amount of discretionary spending and staff professionalization should be considered. This decision may be made with input from the committee itself and/or the corporation's outside auditor or financial advisor.

The audit committee should be distinguished from the finance committee. Often these two committees have parallel memberships, but their functions are quite different. The audit committee is a governance body concerned with the integrity of the corporation's financial procedures. The finance committee is concerned with the mechanics of the corporation's financial operations. Depending on the nature and maturity of the corporation, it may be solely a governance body, or may be partly a governance body and partly an operational body.

In some cases, the role of the finance committee will be filled instead by a single board member, usually called a Treasurer or Finance Vice President.

Where the organization chooses to have a finance committee, it normally deals with such matters as budgets and regular reporting of financial results to the board. It may also address such issues as procurement, cost controls, and asset management. If the organization is a charity, treatment of assets may be subject to statutory or common law requirements. In these cases, the committee's work should be structured to ensure these requirements are met.

The audit committee's mandate occasionally includes responsibility for the corporation's legal compliance. Because the law is ever-changing, sizeable resources (either staff, committee members or outside counsel) need to be continuously, or at least at short regular intervals, devoted to monitoring legal developments that may affect the corporation.

Owing to the the fact that this work is continuous and related to operations, it is preferred that this function be delegated to the finance committee or another committee. However, where the board has made it the responsibility of the audit committee, directors should consider that audit committee expertise is apt to focus on accounting, and ensure the composition of the committee and the resources available allow it to properly carry out assessment of legal compliance.

Executive Committee

This committee is characteristically on-going. It oversees the organization generally, and particularly direction of staff, between full board meetings, and normally has the capacity to bind the corporation. Members of the executive committee should also be members of the appointing board.

Because of the power an executive committee has, it must be constituted through the bylaws.[2]

Industry Canada's Policy Summary on Not-for-Profit Corporations, which applies to federally incorporated corporations, states:

Where the bylaws provide for an executive committee, they must also provide:

1) The procedures for holding meetings of the executive committee.

2) The quorum for executive committee meetings [fixed at a minimum of two directors].

3) A reasonable period of notice of executive committee meetings, or indication that reasonable notice will be given.

4) The manner of appointment or election of executive committee members.

5) The manner in which executive committee members are removed.

6) The responsibilities or duties of executive committee members.

7) The remuneration of executive committee members.[3]

Executive committees have the power to bind the corporation, but they cannot be delegated authority to distribute assets, dissolve or merge the corporation, or take other decisions affecting the fundamental mandate or structure of the corporation.

Although a committee can be designated by board resolution to oversee management of the not-for-profit corporation, its authority should be considered as more limited than that of a committee mandated by bylaw. For instance, giving it a general power to bind the corporation may be challenged as improper. When this type of oversight committee is appointed by resolution, it should be called something other than an "executive committee" to avoid confusion or the danger of third parties relying inappropriately on its apparent authority.

When deciding on the composition of the executive committee, the board should try to:

- obtain the range of skills necessary for the committee to carry out its functions;
- achieve a diversity of membership that adequately represents appropriate geographical areas or constituencies; and,
- allow for frequent meetings at low cost (this typically means either ensuring geographic proximity of members or making provisions for electronic participation in meetings).

The full board should be briefed on decisions made and actions taken by the executive committee at the earliest possible opportunity. In some cases, the executive committee may want to make an interim decision on a matter, which is effective only until the full board considers the matter. If the executive committee has any doubt about its authority to deal with a matter, it should seek legal advice on the scope of its power and/or refer the matter for consideration either by the full board or by the membership, as appropriate.

Procedures

The procedural formality used in committees can vary enormously. A key advantage of committees is that they have fewer participants and more flexibility in their proceedings. This allows for more efficient processing of information and quicker decision making.

Directors should be aware, however, that delegating responsibility to a committee does not necessarily protect them from liability arising from committee decisions or actions. In practice, directors should always ensure that they have access to committee minutes and records. They are legally entitled to any such material.

The legitimacy of committee meetings, like other meetings, can be challenged if its members have not been afforded procedural fairness. Even where the committee operates very informally, there should be provision for:

- notice of meetings;
- adherence to quorum requirements;
- certainty as to the subject matter under consideration;

• availability of minutes and records for review; and,
• opportunity to record dissent.

In many cases, these procedures do not have to be committed to writing. However, board and committee members should always be mindful of them. If the procedure is recorded somewhere, this will save having to refer the matter to the full board or having to institute more formal policies should a dispute occur.

Precisely how much oversight the full board should exercise over a committee depends on the amount of power and the scope of subject matter that it gives to the committee. It may also depend on whether the committee is composed solely of board members or includes outsiders. For instance, there is minimal need for a board to supervise the procedures of an advisory board. But if a committee is empowered to bind the corporation, then the board should make sure that there are procedural safeguards in place. These include:

• careful vetting of candidates for committee membership (any possible hidden agendas or potential personality conflicts?);
• the board retaining the right to designate the committee chair;
• regular or occasional review of the committee minutes and records; and,
• annual, or more frequent, reporting by the committee to the full board.

Committees can inform the full board of their work through minutes, oral or written reports, or recommendations. Minutes are typically submitted so that the board can monitor the functioning of the committee. Reports may or may not contain recommendations. If they do, the recommendations should be listed at the conclusion of the report. If the report is being considered as part of the agenda of a board meeting, there is no need to pass a motion to 'receive' it.[4] In rare instances, a board may wish to 'adopt', 'accept' or 'agree to' a report. This means that the board concurs not only with the findings contained in the report, but also with the deliberations of the committee as set out in the report. It is very unusual for a board to want to endorse a report in this manner. Not having partaken in the work, board members are unlikely to want to concur with all its nuances.

Instead, the board should address its attention to the recommendations, presented either as part of the report or separately. It can vote to implement the recommendations or to take other measures with regard to them that it deems appropriate – including, for instance, rejecting them or returning them to the committee for reconsideration.

A note on advisory boards

Many not-for-profit corporations create an 'advisory board', typically to advise on fulfilment of the corporation's mission and/or to enhance its public credibility. These boards do not take a direct hand in governing the corporation. To avoid any possible misunderstanding by the public or stakeholders, it is important that the relationship between the advisory board, the board of directors and the staff be well defined. The corporation should be able to explain these relative roles to third parties if they are asked. When describing members an advisory board, it should be made clear that they do not have authority over organizational activities. The term 'director' should be avoided.

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SAMPLE QUESTIONS FOR PROSPECTIVE DIRECTORS TO ASK THE ORGANIZATION

1) What is the committee structure of the board?
2) What standing committees are contemplated in the corporation's bylaws?
3) What is the mandate and role of each of the standing and special committees of the corporation?
4) Are there any advisory or honourary committees of the corporation, and what is their role and composition?

SAMPLE QUESTIONS FOR DIRECTORS TO ASK THEMSELVES

1) Given my skills and experience, what committee or committees is it appropriate for me to serve on?
2) Any there any committees I should keep informed about the decisions or activities of, even though I don't serve on them?
3) Am I satisfied that the procedures of the committees I serve on are appropriate given their mandate and composition?

COMMITTEES CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Committee structure	Full board	Annually	Is the existing committee structure the best division of responsibilities to accomplish the corporation's mandate and the board's work? Are the terms of reference and membership of each current committee clearly stated somewhere in the corporation's documents? Is there adequate insurance coverage in place to deal with any claims that may arise from committee work?
2. Mandating of committees	Full board and committee chairs	At inception of committee	Do the committee terms of reference provide for: chair (how selected); composition (size and how selected); reporting responsibility (to whom and when); mandate (scope of authority); nature of authority (report, recommend, act); and, resource and/or staff support?
3. Committee procedure	Full board and/or committee chairs	Annually	Are committee procedures clearly stated? Is there recourse if there is a challenge to the fairness of a committee's proceedings?
4. Standing committees	Full board	Annually	If the bylaws provide for standing committees, are they mandatory or optional? Are the required committees functioning?
5. Operations	Full board	Annually	Is there an executive committee, or other body, responsible for dealing with the corporate matters between board meetings? If not, what is the procedure for taking decisions that cannot be dealt with by the full board in a timely way?

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
6. Governance	Full board	Annually	Is there a committee responsible for overseeing board governance issues, such as a nominating committee? If not, how are these issues dealt with?
7. Audit	Full board	Annually	Is there a committee responsible for liaison with the auditor, and if not, whose role is this?
8. Finance	Full board	Annually	Is there a committee responsible for overseeing the corporation's financial operations, and if not, whose role is this?
9. Advisory committees	Full board	Annually	Is the role and membership of any advisory body clearly set out somewhere is the corporation's documents? Is adequate insurance in place to cover any liability that may arise from such work?

6

Risk Protection

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INTRODUCTION

Generally

Risk can be defined as the possibility that something harmful or undesirable may happen. In their work, directors of not-for-profit corporations potentially face two distinct harmful or undesirable happenings:

(a) that something will occur that adversely affects the corporation; and,
(b) that they will be sued or otherwise held to account for a detrimental occurrence arising from their actions or inactions.

This chapter focuses on the second of these.

None of the various protections available to directors – due diligence, indemnification by the corporation, statutory provisions, insurance – are intended to provide an absolute protection against wrongdoing. However, they are meant to provide some latitude for honest mistakes, without unduly endangering the corporation.

Risk assessment is a key part of any director's job, so it is perhaps appropriate that one of the first things a prospective director should do is assess whether there are sufficient protections available to make him or her comfortable in serving on the board of a particular not-for-profit corporation. The information set out below should be helpful in making that determination.

Exposure

Liability risks for directors of not-for-profit corporations can arise by statute and at common law. A director can be held personally liable for his or her own actions or inactions – jointly (together with one or more of the other directors) and severally (individually). A summary of the most common

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liability risks faced by directors of not-for-profit corporations, including specific reference to charitable corporations, where applicable, may be found in Chapter 3.

Chapter scope

This chapter deals with selected legal risks faced by directors of not-for-profit corporations, and provides an overview of some steps that can be taken to protect against liability exposure. An exhaustive discussion of all liability risks would make the chapter disproportionately long. The chapter begins with a review of due diligence in various contexts, then discusses corporate indemnification, statutory protections, and insurance. A final section deals with some miscellaneous means of reducing liability exposure.

DUE DILIGENCE

Generally

As part of their fiduciary duty, directors of not-for-profit corporations have an obligation to exercise due diligence in overseeing and managing the operations of the corporation. This includes, for instance, attending board of directors' meetings, supervising the operations of the corporation, monitoring compliance with the corporate objects as set out in the corporation's letters patent, and ensuring that resolutions adopted by the board are based upon informed decisions of the directors.

Due diligence also means that directors must be familiar with all aspects of the corporation. For this reason, directors should avoid missing board of directors' meetings if at all possible. If a director cannot be present at a board meeting, the director should arrange to review the minutes of the meeting and any financial statements or reports that were presented. If a matter is not clear to the director, he or she should follow up with appropriate questions at the next board meeting.

The obligation of directors of not-for-profit corporations to oversee the operation of the corporation and ensure compliance with the corporation's objects is an onerous one. Some models of board governance – notably originating in the United States – advocate that directors limit themselves to policy matters only and leave responsibility for administration and day-to-day matters with the executive staff of the corporation.[1] This limited role for directors does not reflect the obligations that are legally imposed upon directors, particularly directors of charitable corporations, in Canada.

The implementation of due diligence by the board of directors provides a good defence to claims of negligence and to alleged violations of some statutory liabilities.

EXAMPLE

Under the *Income Tax Act* (Canada), directors of not-for-profit corporations have a duty to provide various governmental filings and to remit source deductions of income tax to the Canada Customs and Revenue Agency. To avoid liability, directors must be able to show that they took positive action to see that the corporation complied with the requirements of the Act. If directors can show that they exercised the degree of care, diligence and skill that a reasonably prudent person would have in the same circumstances, they will not be personally liable for the corporation's failure to comply with the Act.

Due diligence does not provide a defence for all statutory violations, however. Under the *Anti-terrorism Act* (Canada), directors of charitable corporations may be liable for the actions of the charity in facilitating a 'terrorist activity' even though the directors may have exercised appropriate due diligence to prevent such events from occurring. Directors and their legal advisors should carefully review the *Anti-terrorism Act* (Canada) and related federal legislation to ensure that the corporation complies with the provisions and guards against becoming unwittingly caught by such legislation.

Liability risk for lack of corporate authority

The activities of a not-for-profit corporation can only be undertaken within the parameters of the corporate objects set out in its letters patent, and any amendments in its supplementary letters patent. Certain activities may also require authorization by bylaw.

If directors allow the corporation to undertake activities that are outside the authority of the corporation's objects or not duly authorized by bylaw (i.e., *ultra vires* activities), they will become exposed to personal liability for the consequences of those actions.

To avoid this type of liability, directors should:

- obtain and carefully review the corporation's letters patent and any supplementary letters patent when they first become a director;
- obtain and carefully review the current general operating bylaws for the corporation; and,
- ensure that the board of directors reviews all of these corporate documents at least once a year.

If the corporation is considering undertaking new activities that go beyond what is spelled out in its letters patent, it must amend its corporate objects. This is done in supplementary letters patent. These must be obtained before undertaking any new activities. Supplementary letters patent amending the corporate objects cannot be granted retroactively. If a charitable corporation is considering amending its objects, the board of directors must first obtain approval from Canada Customs and Revenue Agency and, for charities incorporated in Ontario, from the Office of the Public Guardian and Trustee.

Contract liability risk for directors

Directors who sign contracts for a not-for-profit corporation may face potential liability if the contracts entered into were not properly authorized by board resolution, or if the directors knowingly induced breach of the contract subsequent to the contract being signed. To reduce this possibility, directors should ensure that corporate contracts are duly authorized by the board of directors, and by members of the corporation when this is required by statute. Directors also need to exercise due diligence in ensuring that the terms of the contracts are complied with in order to avoid any allegations of their wrongful interference in inducing breach of contract.

Liability risks for negligent mismanagement

Directors of not-for-profit corporations may also face personal liability where the activities of the corporation are alleged to have been negligently mismanaged by its board. Some examples of negligent mismanagement are where the directors have permitted unsafe conditions to exist on the corporation's property which leads to a slip and fall incident, or they have permitted the negligent operation of a corporate vehicle or a third party vehicle that is involved in activities on behalf of the corporation.

Directors need to exercise due diligence in ensuring that, in situations where third party injury may be fully or partly attributable to a board policy or arise directly out of the conduct of board members, they carefully scrutinize the possible implications of their action or inaction.

Screening

A number of high profile court cases involving not-for-profit corporations in recent years have dealt with abuse claims. The most common allegations are of sexual, physical and/or emotional abuse. To date, these cases have focused on the corporation's liability, rather than the liability of directors. Directors need to be concerned about the prevalence of such claims, however, for two reasons:

- the damages resulting from abuse claims can render a corporation bankrupt, insolvent or so impoverished that – for all practical purposes – it ceases to be able to function; and,
- where the abuse was partly attributable to corporation policy or occurred where there was direct involvement of directors, they could be personally liable.

Because of this, in a corporation dealing with clients or others vulnerable to abuse, such as children, there should be a screening policy or protocol in place. Screening can also be implemented to reduce other liability risks, such as fraud or theft.

An appropriate screening process will, at a minimum, involve:

- risk assessment (i.e., determining the nature and extent of the risk);
- adoption of reasonable measures to take in the circumstances (in view of the risk assessment, standard of care required, costs, etc.);
- consistent application of screening (i.e., assessment of all those who seek or hold a particular position in the same way);
- integration of the results of screening into decision making;
- appropriate controls on the information gathered through the screening;
- on-going assessment of the effectiveness and implementation of the process; and,
- implementation of criminal record checks, where appropriate.

In developing a screening process, legal advice should be sought to ensure the policy or protocol meets statutory requirements arising from privacy, human rights, labour and other legislation.

Not-for-profit corporations should obtain consents from both current and applicant employees or volunteers and conduct criminal record checks before permitting them to work with children and others vulnerable to abuse. Criminal record checks should be supplemented by other means of verifying the background and reliability of individuals.

Corporations dealing with vulnerable individuals or groups should adopt and implement written sexual abuse and harassment policies addressing such issues as screening, reporting procedures and discipline. Written policies assist in demonstrating that the corporation and its directors exercised due diligence with respect to potential abuse of children and other at-risk populations.

Reliance on assistance and advice

Directors of not-for-profit corporations are required to exercise due diligence in making decisions about the operations of a corporation and the management of its assets. However, a board of directors does not always have all of the knowledge, expertise and experience required to fully perform the statutory and common law duties imposed upon them. They often need to rely on assistance and advice from management of the corporation and on advice from outside professionals.

Reliance on management

Directors of not-for-profit corporations are entitled to rely on assistance and advice from management of the corporation to the extent that it would be prudent for them to do so. The board of directors can delegate the day-to-day operation of the corporation to management, but directors must remain responsible. They must maintain proper supervision and control over the decisions and actions taken by management. Delegating responsibilities or relying on assistance and advice from management does not relieve directors from liability. It is therefore important that the board of directors receives and reviews reports from management at each board meeting.

Reliance on outside professionals

Directors of not-for-profit corporations, particularly charitable corporations, often need to obtain advice from outside professionals (e.g., lawyers, accountants, and tax professionals). These professionals are typically called in whenever the complexity of an issue or the degree of liability involved are beyond what the board is able to handle competently on its own. Indeed, it is often wise to retain outside professionals because:

- ■ Operating a not-for-profit corporation, particular a charitable corporation, involves complex legal, accounting, tax and other issues. If neither the board of directors nor management of the corporation have sufficient knowledge about these issues, then the board of directors has a duty to seek advice and assistance to ensure compliance with the applicable laws and the common law duties imposed upon them.
- ■ The corporation and its board of directors will be able to more effectively 'shift the legal risk away' from the corporation and themselves by downloading those risks to outside professionals, who will likely carry professional liability insurance.
- ■ Reliance on outside professionals provides evidence of due diligence by the directors and helps to insulate the directors from liability.

When retaining outside professionals, the board of directors of a not-for-profit corporation must:

- ensure that the professionals chosen are qualified;
- ensure that the professionals have been given appropriate instructions and terms of reference; and,
- exercise prudence in requiring appropriate reports

of the work being performed by the outside professionals and in making decisions to either act or not upon the advice that is given by the outside professionals (i.e., merely obtaining outside reports and endorsing them without considering their pertinence or merit will not be sufficient to discharge the duty of a director).

Board members who are professionals themselves should not be asked to provide professional advice to the corporation. For both economic and practical reasons this should be avoided:

- It is unfair to these board members because they will not likely fully charge for their services. If the corporation is a charitable corporation operating in Ontario, these board members would be statutorily prohibited from charging at all for their services.
- Other directors may be reticent about questioning the professional opinion of a colleague. If the opinion turns out to be unsound, it could be both awkward and unpleasant to hold a fellow board member liable for negligence for his or her advice. This is especially true when the board member in question was only intending to act as an unpaid volunteer in giving the advice.

INDEMNIFICATION

Generally

Indemnification is an agreement by the corporation to cover the cost of, or compensate directors for, losses or damages caused by lawsuits based on the director's actions or inactions in his or her capacity as a director. The undertaking to pay these costs must be set out in the corporate bylaws. Indemnification usually includes coverage for the cost of defending legal actions. Coverage may or may not extend to situations where the action is successful and the director is culpable; however, normally indemnification will not apply in situations where the act is illegal.

All not-for-profit corporations

Federal statutory provisions

The *Canada Corporations Act*[2] permits a not-for-profit corporation to adopt a bylaw indemnifying the directors and officers of the corporation against all costs relating to any action or legal proceeding that arises from the execution of their duties of office. This does not apply to legal action that results from directors' or officers' own wilful neglect or default.

It is advantageous and advisable to adopt an indemnification bylaw. However, such a bylaw would be of little help in situations where:

- the corporation does not have sufficient assets or insurance coverage to meet the financial obligations of the indemnity;
- a director's or officer's acts were beyond the scope of his or her authority as a director, or a director acted without good faith or acted dishonestly;
- a director's or officer's actions or inactions constitute wilful neglect or default;
- a director's or officer's actions or inactions constitute a breach of his or her own fiduciary obligations to the corporation, even if this did not amount to wilful neglect or default;
- a director or officer is held personally liable for statutory monetary payments, such as unpaid wages or government deductions; or

- a director or officer is involved in a *Criminal Code* offence, such as sexual abuse against children or violation of provisions of the *Anti-terrorism Act* (Canada).

Although the *Canada Corporations Act* allows not-for-profit corporations to indemnify directors and officers, some corporations do not adopt indemnification bylaws. Others fail to ensure that the bylaw is properly adopted. Typically this happens because:

- the corporation has been in existence for a number of years and its board of directors was never advised of the importance of passing an indemnification bylaw;
- the wording of the indemnification bylaw incorrectly reflects the indemnification provision of a business corporation rather than the indemnification provisions contained in the *Canada Corporations Act* for not-for-profit corporations[3]; or
- the indemnification bylaw was never approved by the members of the corporation as required by the *Canada Corporations Act*.

Provincial statutory provisions

In Ontario, the *Corporations Act* (Ontario)[4] allows not-for-profit corporations to adopt a similar form of indemnification bylaw as that found in the *Canada Corporations Act*. Under the *Corporations Act* (Ontario) and similar corporate legislation in other provinces, a corporation may indemnify its directors and officers for personal liability arising from an act or omission in performing their duties. However, an Ontario not-for-profit corporation may not indemnify a director or officer for liability arising from a failure of the director to act honestly or in good faith in performing those duties.

In Québec , the *Companies Act* allows directors to be indemnified "with the consent of the corporation given at any general meeting thereof" for costs, charges and expenses sustained in relation to a suit or proceedings brought against them with respect to the execution of their duties or in relation to the affairs of their office, if they are not occasioned by their own fault.[5] This bylaw can either be in regard to a particular action or apply more generally. In practice, a general bylaw providing for mandatory indemnification is preferred. This avoids directors being at the mercy of the members when the need for indemnification with respect to a specific matter arises.

Sometimes provincial statutes provide for indemnification within court proceedings, as well as or instead of by way of a bylaw.

For instance, the *Societies Act* (British Columbia) requires court approval of indemnification. It also requires honesty and good faith, and – in some contexts – reasonable grounds for believing the conduct was lawful. Section 30(2) of the Act provides:

> A society may, with the approval of the court, indemnify a director or former director of the society or a director or former director of a subsidiary of the society, and his or her heirs and personal representatives, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgement, actually and reasonably incurred by him or her, in a civil, criminal or administrative action or proceeding to which he or she

is made a party because of being or having been a director, including an action brought by the society or subsidiary, if:

(a) he or she acted honestly and in good faith with a view to the best interests of the society or subsidiary of which he or she is or was a director, and

(b) in the case of a criminal or administrative action or proceeding, he or she had reasonable grounds for believing his or her conduct was lawful.

Directors of not-for profit corporations need to carefully determine what, if any, indemnification provisions govern in their jurisdictions.

Charitable corporations

> **NOTE**
>
> *The following comments deal both with indemnification and insurance; see below for a discussion of the more general aspects of insurance.*

The Office of the Public Guardian and Trustee in Ontario has taken the position that a charitable corporation in Ontario cannot indemnify its directors or purchase directors and officers liability insurance without first obtaining court approval. Its rationale is that these measures are a perceived benefit to directors. This extension of the common law rule prohibiting remuneration of directors of charitable corporations has proved to be an awkward restriction on the operation of charitable corporations.

As a result, the *Charities Accounting Act* has been amended and now includes regulations that allow a charitable corporation in Ontario to indemnify its directors or officers from personal liability for acts or omissions arising from the performance of their duties. Charities must follow the requirements of the regulations and cannot indemnify a director for liability arising from a failure to act honestly or in good faith.

The same regulations permit charities to purchase directors and officers insurance to cover personal liability arising from the acts or omissions of directors or officers in performing their duties. However, the terms of the directors and officers insurance and the terms of the indemnification bylaw may not impair a third party's right to bring legal action against the director or officer. The regulations also state that the purchase of the insurance policy must not unduly impair the carrying out of the religious, educational, charitable or public purposes for which the charity holds property. The board of directors of the corporation must consider the following criteria before giving an indemnity or purchasing directors and officers insurance:

- the degree of risk to which the director or officer is or may be exposed (e.g., a charity engaged in research will likely be at less risk than a charity engaged in service delivery);
- whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance (e.g., can the charity institute procedures or designate staff to monitor and respond to the risk);
- whether the amount or cost of the insurance is reasonable in relation to the risk;
- whether the cost of the insurance is reasonable in

relation to the revenue available to the charity; and,
- whether it advances the administration and management of the charitable property to give the indemnity or purchase the insurance.

The regulations state that a charity cannot pay an indemnity or purchase insurance if, as a result, the amount of debt and liability of the corporation would exceed the value of the charitable property or would render the corporation insolvent. In addition, the indemnity may only be paid or the insurance purchased from the charitable property to which the personal liability relates and not from any other charitable property. This means that income from donor restricted funds, such as endowment funds, that would otherwise not normally attract liability for a director or officer should not be used to purchase directors and officers liability insurance or to pay an indemnity claim. Diversion of such monies for indemnification or insurance could be challenged as use of the charitable property for an improper purpose.

For federally incorporated charities, and in common law provinces other than Ontario – where the matter has been dealt with through legislation – the question of whether indemnification or insurance constitutes a benefit for directors of charities has not been settled. If not improper, such measures in these jurisdictions are at least subject to being challenged unless sanctioned by a court. Since Québec is a civil law jurisdiction, this issue does not arise.

INSURANCE

Generally

Boards should consider obtaining one or more of the various types of insurance coverage available, as is appropriate given their corporation's work and resources.

All not-for-profit corporations

Directors and officers liability insurance

The general liability insurance policy of a not-for-profit corporation provides only limited protection to directors or officers against any alleged wrongful acts. This type of policy, which is commonly carried by corporations, usually protects against claims arising in the context of the organization's operations.

A corporation that is involved in activities that may expose directors or officers to personal liability should obtain a separate insurance policy for its directors and officers to supplement its general liability insurance coverage. Directors and officers liability policies typically protect against claims arising out of board decisions or omissions, or out of actions or activities performed directly under the auspices of the board or directors. Where directors and officers act as trustees, claims arising from that aspect of their work are not covered by standard directors and officers liability insurance. A 'fiduciary liability' policy is required to protect against these types of claims.

There are as many different kinds of directors and officers liability insurance policies as there are insurance companies. Typically, these policies protect directors and officers of not-for-profit corporations for the following:

- damages which they become legally obligated to pay and for which the corporation cannot or will not pay; and,
- claims made against a director or officer whom the corporation is obliged to indemnify.

Some of the more important considerations to keep in mind when obtaining directors and officers liability insurance are the following:

- The policy should extend to all past and present directors, officers and committee members of the corporation.
- Directors and officers insurance policies are normally issued on a "claims made basis." This means that the corporation must notify the insurer before the termination of the policy period of any possible or potential claims that the directors and officers of the corporation may be aware of.
- The policy should include a provision that notice of cancellation of the policy be directed not only to the corporation but also to the chair of the board of directors. This will ensure that the board is notified of any intended cancellation of the policy.
- Directors and officers liability insurance complements the general liability insurance coverage of the not-for-profit corporation. Therefore, the amount of coverage should, if possible, match that of the general liability policy, assuming that this much coverage is available and the not-for-profit corporation can afford the premiums.
- A directors and officers liability policy insures against risks that are not covered under the general liability insurance policy, but does not cover all actions against directors and officers. Therefore, it is important for directors to review the exclusions in the coverage and, where possible, to consider obtaining any necessary additional coverage (such as a fiduciary liability policy).
- Directors and officers liability insurance of a not-for-profit corporation will probably not provide coverage for actions by public authorities for breach of trust arising out of a mishandling of trust funds, improper investments, violations of the *Anti-terrorism Act* or other statutory violations.

Limitations in general liability protection

General liability insurance policies often contain limitations in coverage. Directors of a not-for-profit corporation should review their general liability coverage and be aware of any limitations. These may include:

- insufficient amount of insurance to cover all anticipated risks;
- exclusion of coverage for sexual and/or physical abuse of children;
- exclusion of coverage for sexual harassment;
- limitation on the geographic area covered by the policy;
- limitation on who is covered under the terms of the policy;
- exclusion of coverage for penalties and fines;
- limitations on legal cost coverage;
- exclusion of coverage where the corporation has failed to advise the insurer of changes in insurable risks; and
- exclusion of coverage where the corporation has failed to report claims to the insurer on a timely basis.

Insurance coverage for sexual abuse and/or harassment

If the not-for-profit corporation's current insurance policy does not provide protection for sexual abuse and/or harassment, but the corporation faces a risk in this regard, the board of directors must be made aware of this lack of coverage. The directors stand a significant risk of being exposed to personal liability if such claims should arise.

Where insurance coverage for sexual abuse and/or harassment is available, it is advisable to obtain it on an "occurrence basis" rather than a "claims made basis."

"Occurrence based" policies provide coverage for all incidents occurring during a particular period in time (i.e., the coverage period of the policy), regardless of when the claim is made and whether or not a future board of directors remembers to maintain the insurance policy in the future.

"Claims made" policies, in contrast, provide coverage only if the policy is in effect when the claim is made, regardless of when the event causing the claim occurred. It is not retroactive. This means that claims for abuse allegations that were made prior to the implementation date of the "claims made" coverage would be expressly excluded from coverage. This may result in gaps in insurance coverage for either past or future incidents, which in turn could lead to increased liability exposure for the directors of the corporation.

In summary, it is generally in the best interests of the board of directors to ensure that the corporation has insurance coverage for sexual abuse and/or harassment and, if possible, that is "occurrence based."

Charitable corporations

All of the above comments concerning insurance for not-for-profit corporations apply equally to charitable corporations, except for the purchase of directors and officers liability insurance policies. In Ontario, as explained above, the Office of the Public Guardian and Trustee in Ontario takes the position that the purchase of directors and officers liability insurance by a charitable corporation provides a personal benefit to the directors. However, regulations under the *Charities Accounting Act* (Ontario) now permit charitable corporations to purchase directors and officers insurance, provided that they comply with the statutory requirements contained in the regulations. (For a summary of the Ontario regulations, and a discussion of the law in other jurisdictions, please refer to the note on **Charitable corporations** in the section of this chapter that deals with indemnification.)

STATUTORY PROTECTION

Generally

Directors of not-for-profit corporations are, by-and-large, not accorded as much statutory protection as their counterparts in business corporations. The *Canada Corporations Act* provides only limited statutory protections to not-for-profit directors. These are set out below.

Protection from third party contractual liability

Under the *Canada Corporations Act*,[6] directors and officers of a not-for-profit corporation are not in the normal course subject to personal liability to any third parties when they enter into a contract, agreement, or engagement with another entity, so long as they are acting within the scope of their authority as agents or servants of the corporation. (Note, however, that in such dealings section 27 of the Act holds directors potentially liable in circumstances where there is flawed or incomplete identification of the corporation in the written instrument relating to the transaction.)

Protection from conflict of interest

Directors of not-for-profit corporations have a duty to avoid conflicts of interest or even the appearance of a conflict of interest. This means that if a director directly or indirectly profits from his or her dealings with or from his or her position in a not-for-profit corporation, the director will be in breach of his or her fiduciary duty and will be held accountable to the corporation for the benefits received. The *Canada Corporations Act*, however, has relaxed this common law rule by allowing directors to enter into otherwise improper arrangements without running the risk of being in breach of their fiduciary duty.

The *Canada Corporations Act*[7] states that if a conflict exists, the director must declare the conflict of interest at the meeting of the board of directors and not participate in any discussion or vote (see Chapter 2 for fuller discussion of these provisions). If these statutory requirements are met, the interested director will not be held accountable for the benefit received and the director will not be liable for the profit realized by any contract that he is directly or indirectly interested in where a contract has been confirmed by the vote of members at a special general meeting called for that purpose.

OTHER MEANS OF REDUCING LIABILITY EXPOSURE

There are a number of other practical measures that can be taken for board members to reduce their exposure to liability. A few of the simpler means that can be adopted are:

- Strike a legal risk management committee to identify areas of risks, to recommend remedial steps that can be taken, and generally to advise the board of directors on implementing appropriate procedures or measures to establish the due diligence of the board.
- Encourage directors to obtain independent legal advice in situations where they may be facing a high degree of exposure to personal liability (e.g., where the corporation faces insolvency). This allows directors to independently determine the level of personal risk that they are prepared to accept.
- Reduce the numbers of persons serving as members on the board of directors (i.e., diminish the likelihood of an ill-advised decision being taken).
- Increase the use of committees and advisory boards made up of individuals who are not board members (i.e., create a structure that increases resources and diversifies responsibility for dealing with various aspects of the corporation's operations).
- Transfer personal assets of board members to their spouses before joining the board of directors.

?

Sample questions for prospective or current directors to ask the organization

1) Are the corporation's policies written down and distributed to all board members?
2) Has the corporation conducted an assessment of its legal risks? When was this done? By whom?
3) Do the corporation's bylaws provide for indemnification of directors?
4) Does the corporation do everything it can to inform directors about and protect them from any possible litigation?
5) Does the corporation routinely deal with children or other vulnerable populations? Does the corporation have a screening policy? If so, what is it and how is it carried out? Is there provision in the screening policy for obtaining consents from individuals subject to security checks? Does the corporation have a written policy dealing with sexual abuse?
6) Does the corporation have in place adequate insurance to cover potential liability? How often is this insurance coverage reviewed? By whom?
7) Does the corporation have directors and officers liability insurance for its directors? What is covered and what is excluded?

Sample questions for prospective or current directors to ask themselves

1) Have I read all of the corporation's policies and do I understand them?
2) Do I understand any legal risks that the corporation may face?
3) Do I understand the legal risks that I may face when serving as a director of a not-for-profit corporation?
4) Do I know how to limit my liability as a director of a not-for-profit corporation?
5) I am satisfied that the corporation's screening practices are appropriate given the nature of its activities?
6) Do I understand the insurance coverage that is in place for the corporation and for its directors?
7) Do I understand what is covered and what is not covered?

RISK PROTECTION CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Due diligence	Full board	Annually and/or at the time of the decision or transaction	Have the requirements of due diligence been met before a particular decision is taken or particular transaction is entered into?
2. Screening	Full board	Annually	Are the corporation's screening practices appropriate in light of our current operations? What is the mechanism for monitoring implementation of the screening, and is this adequate?
3. Reliance on management	Full board	Annually	Is there adequate and on-going supervision of management in light of the responsibilities that have been delegated to them?
4. Reliance on experts	Full board	At the time of the decision or transaction	Is the board satisfied with the expert's credentials and with the quality of the work or advice? Has the board carefully weighed the expert's input, and then taken an independent decision on the issue?
5. Indemnification	Full board	Annually	Do the corporation's bylaws provide for indemnification, and does that indemnification accord with the requirements of the incorporating legislation? If the corporation is a charity, is the indemnification authorized by statute or a court; if not, what steps (e.g., obtaining a legal opinion) has the corporation taken prior to providing indemnification?

6. Insurance, general	Full board	Annually	Does the corporation have adequate and appropriate insurance coverage, considering its mandate and activities. What are the scope and limitations of the insurance policies it has in place?
7. Insurance, directors and officers liability	Full board	Annually	Does the insurance coverage extend to committee work by board members, and/or to committee work by non-board members? Does it cover individuals who may be involved in corporate governance even through they do not sit as board members – i.e., members of advisory bodies? If not, is insurance necessary and provided for in these instances?
8. Other measures to reduce liability	Full board and individual directors	Annually	Have the directors as a group, and as individuals, taken all possible steps to reduce their exposure to liability?

7

Taxation

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INTRODUCTION†

Registered charities and other not-for-profit corporations benefit from special tax treatment. All not-for-profit corporations are exempt from taxation on their income.[1] As well, registered charities can issue donation receipts, which entitle individual donors to a tax credit and corporate donors to a tax deduction.[2] To maintain their special status, not-for-profit corporations and registered charities must meet certain requirements of the Canada Customs and Revenue Agency. In Québec, a parallel registration regime exists, which mirrors federal requirements.

The tax legislation and regulations governing not-for-profit organizations, and particularly charities, are quite restrictive. Depending on the goal, it may be possible to address certain regulatory restrictions by organizing activities into several inter-related corporations. A number of such interlocking structures are discussed at the end of this chapter.

NOT-FOR-PROFIT CORPORATIONS

Not-for-profit corporations that are not charities, and that fall within the definition of "non-profit organizations" set out in Section 149(1)(l) of the *Income Tax Act*, do not, in general, pay tax on their income, but are subject to tax on income from investments or property, and may be subject to other types of tax – e.g., Goods and Services Tax, sales tax or property tax. In some cases not-for-profit corporations may qualify for exemptions or preferential rates, by meeting the definition or requirements found in the legislation or regulations establishing the tax. Maintaining non-profit status for purposes of the exemption on income tax requires that the not-for-profit corporation not permit any income from corporate operations to flow as a personal benefit to members. There is a limited exception to this requirement for certain amateur athletic associations.[3]

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Non-profit organizations are also precluded from earning and accumulating excess income beyond what is considered reasonable to meet the organization's purposes.[4]

CHARITIES

The *Income Tax Act* gives "registered charities" and "qualified donees" the right to issue donation receipts. Qualified donees, as defined in the *Income Tax Act*, include organizations that are not necessarily charitable at law but that the government deems worthy of donation support.[5]

Qualified donees include, but are not limited to, registered Canadian Amateur Athletic Associations, Canadian municipalities, the United Nations and its agencies, and certain foreign universities and charities.

Registered Charities

"Registered charity" is defined in the *Income Tax Act* as a "charitable organization, private foundation or public foundation" that is resident in Canada, that was established or created in Canada, and that is registered with the Minister of National Revenue.[6] "Charitable organization", "private foundation", and "public foundation" are each separately defined and regulated under the Act.[7]

All registered charities must be "exclusively charitable" in purpose and in actual fact. While the *Income Tax Act* defines almost all of the permissible and impermissible activities of registered charities against this standard, it does not define "charity." Instead, the Canada Customs and Revenue Agency and the courts rely on the common law definition of charity.

There are two main sources for this common law definition: the 1601 *Preamble* to the *Statute of Elizabeth*[8] and the test set out in the reasons of Lord Macnaghten in the 1891 House of Lords decision in *Commissioner for Special Purposes of the Income Tax v. Pemsel*.[9]

The *Preamble* (rendered from archaic to modern language[10]), defines charity as:

> . . . relief of aged, impotent and poor people . . . the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities . . . repair of bridges, ports, havens, causeways, churches, seabanks and highways . . . education and preferment of orphans . . . the relief, stock or maintenance for houses of correction . . . marriages of poor maids . . . supportation, aid and help of young tradesmen, handicraftsmen, and persons decayed . . . relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers and other taxes.[11]

Although the *Statute of Elizabeth* was repealed long ago, the *Preamble* has been 'absorbed' into the common law, and continues to influence Commonwealth jurisprudence on the definition of charity. A modern reader is supposed to read it by analogy to their own time.

In *Pemsel*, Lord Macnaghten laid out the following classifications of charity:

> "Charity" in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of

> education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.[12]

The *Pemsel* test is a classification, not a definition, but is a useful starting point for an analysis of "charity".

These two tests, and the substantial jurisprudence that interprets and applies them, have been especially important in the law of trusts where qualifying as "exclusively charitable" is essential to the validity of a purpose trust, subject to a few minor exceptions. The same requirement is imposed on entities seeking charitable registration under the *Income Tax Act*. In applying these tests, courts require that the purpose of the entity or trust be exclusively charitable and that the entity or trust be for the "public benefit". This means, in general terms, that the charity must pursue the relevant charitable purpose for the benefit of a large enough segment of society, "the public", in an effective way.

Charitable organizations

Charitable organizations are distinguished from foundations by their active orientation – generally, charitable organizations carry out their own charitable activities. A charitable organization must devote all of its resources to the charitable activities that it conducts. It must not distribute or make available any part of its income to, or for the benefit of, individuals or parties other than the intended beneficiaries.

Certain exceptions apply to various aspects of the standard requirements these organizations must meet. Charitable organizations may make grants totalling not more than fifty percent of their income in any one year to qualified donees. They are allowed to carry on a 'related business'. And they may disburse their income to an 'associated' charity.[13] Charitable organizations may be organized as trusts, corporations or associations.

EXAMPLE

Granting – an organization without a well-developed infrastructure in a geographical area that it is mandated to serve may make grants to a local organization (also a registered charity) in that location to achieve its purposes.

EXAMPLE

Related business – a social service organization may operate a thrift shop in support of its work, or a hospital may run a cafeteria and apply the profits from sales of food to its general revenues.

EXAMPLE

Associated charity – an organization may fund a related organization (also a registered charity) that is mandated to carry out a particular part of its work, such as the provincial chapter of a national organization.

Foundations

Foundations are characterized by their passive orientation – generally, they fund charitable activities that are carried on by other organizations. Foundations must be constituted and operated exclusively for charitable purposes. "Charitable purposes" includes the disbursement of funds to qualified donees (including registered charities).[14] No part of a foundation's income may be available for the personal benefit of any individual or party that is not an intended beneficiary of the foundation's purposes.[15] Foundations must be organized as trusts or corporations. They may not be organized as unincorporated associations.[16]

Executives of registered charities and sources of capital

The *Income Tax Act* includes provisions about the makeup of the executive (officers, directors, and trustees, etc.) of registered charities and about their sources of capital.

Generally, if the registered charity is to be a charitable organization or a public foundation, rather than a private foundation, more than fifty percent of its executive must deal with each other, and with each of the other members of the executive, at arm's length[17] and not more than fifty percent of its capital may have been contributed by one person or by one group of persons who do not deal with each other at arm's length. Determination of whether a relationship is arm's length is made by looking at the extent of the kinship and/or business or other connections between the parties. If the registered charity is classified as a private foundation, it is subject to more stringent regulations.

The *Income Tax Act* provides an exception allowing, in some instances, governments, charitable organizations, public foundations, clubs, societies, and associations to establish public foundations or charitable organizations by contributing fifty percent or more of the capital.[18]

The charitable registration process

Canada Customs and Revenue Agency Charities Directorate examiners decide whether an organization applying for federal charitable registration qualifies based on an assessment of whether it meets the legal definition of charity discussed above.

The Canada Customs and Revenue Agency is not obliged to hear or receive submissions from the applicant. The Charities Directorate does, however, have in place a standard procedure for obtaining clarifications of, or additional information on, problem applications. The applicant may appeal a negative decision to the Federal Court of Appeal.

De-Registration

A charity may be deregistered for:[19]

- failing to comply with the annual information return requirement;
- issuing an improper or false donation receipt;
- failing to continue to meet any of the requirements of registration, including:
    - carrying on any business, if it is a private foundation, or an unrelated business, if it is a charitable organization or public foundation;
    - if it is a foundation, acquiring control of any corporation or incurring certain types of debts;
    - attempting to unduly delay its expenditure on charitable activities by making transfers to another charity;
    - failing to disburse a set proportion of its assets or funds receipted in the previous year for charitable purposes or activities; or
    - failing to keep proper records and books of account.

The decision to revoke a registration is made by the Minister under section 168(1) of the *Income Tax Act*. The Minister gives notice of his intention to revoke by registered mail and offers the charity an opportunity to respond.

Most revocations stem from failure to file the information return. Occasionally, revocations are triggered by audits. Where revocation results from failure to file, organizations should not assume automatic renewal of registration once they file the proper paperwork. Changes in the legal definition of charity over time may mean they no longer qualify.

Revocation can happen as early as thirty days later by publication of the Minister's decision to revoke in the *Canada Gazette*, although usually the process goes on for some time. The charity may appeal to the Federal Court of Appeal.[20]

THE REGULATION OF CHARITIES

The *Income Tax Act* and/or the Canada Customs and Revenue Agency regulate the investment, business, political, borrowing, granting, and international activities of charities. The *Income Tax Act* also mandates certain levels of disbursements for all charities. The regulations pertaining to charitable organizations can be reduced to two basic rules:

1) A charity must be exclusively charitable.

Foundations must be "constituted and operated exclusively for charitable purposes." Charitable organizations must devote "all their resources ... to charitable activities carried on by the organization itself". This means a charity cannot pursue any other purpose – business, investment return, political – except to the extent that it is incidental and ancillary to the charitable purpose or is a means of achieving it. Many of the rules discussed in this chapter either apply more specific requirements to this standard or accommodate certain acceptable practices.

2) A charity must spend a certain percentage of its funds on charitable activity.

The *Income Tax Act* requires that charity be done to a certain quantified benchmark by requiring certain levels of disbursement of funds on charitable activity. These levels are different for charitable organizations and foundations. This required spending is known as the "disbursement quota".

Control of corporations

Foundations may not "acquire control" of a corporation. This prohibition does not apply, however, to a foundation gaining control of a corporation by gift.

Investments

The *Income Tax Act* does not require that a charity's investments earn a specific rate of return. It addresses the issue of investment return only indirectly, by imposing a 4.5% disbursement quota on foundations. Private foundations are subject to certain more detailed and restrictive rules to ensure against manipulation of transactions to artificially reduce the disbursement quota, and to preclude financial benefits being gained by non-arm's length individuals or parties dealing with the private foundation.[21]

Business activities

A registered charity, whether it is a charitable organization or a foundation, is not allowed to conduct an unrelated business. Doing so would violate the exclusively charitable requirement.

Charitable organizations are allowed to carry on a related business. A charity that operates a related business is considered under the *Income Tax Act* to be devoting its resources to its charitable activities.

Nothing in the *Income Tax Act* makes reference to public foundations in this regard. They are, therefore, allowed to carry on related businesses.

Private foundations are explicitly prohibited from carrying on any business, related or unrelated.[22]

Political activities

Registered charities are permitted to engage in political activities under the *Income Tax Act*, but only to a very limited extent. Their right to do so is regulated by two sets of rules, the first related to the definition of charity, the second to the disbursement quota.

- Registered charities are allowed to engage in political activities that are ancillary and incidental to the charity's purposes. Political activity is acceptable provided that the charity devotes "substantially all" of its resources to charitable purposes, and only a part of its resources to non-partisan political activities of an "ancillary and incidental" nature. "Resources" includes all financial, physical, and human resources owned by or available to the charity, not just those that come from receipted donations. The Canada Customs and Revenue Agency defines "substantially all" as ninety percent or more of the resources.[23]
- Registered charities must respect their disbursement quota when allocating resources to political activity, creating an additional constraint on such activity. The amount a registered charity spends on political activities does not count as an expenditure on charitable activities or as a gift to a qualified donee for the purposes of satisfying the disbursement quota.[24] Since these quotas are quite high, there is not much room in the budgets of most charities for permissible political expenses.

Borrowing activities

Charitable organizations are allowed to borrow, if the power to borrow is provided for in their bylaws. Foundations are not allowed to incur debts for purposes other than current operating expenses, purchase of investments and administration expenses.

International activities

A registered charity must be resident in Canada. This significantly restricts the capacity of Canadians and Canadian charities to do charity abroad. There are, however, three ways under the *Income Tax Act* that a registered charity can do charitable work outside of Canada.

- A registered charity may carry on its own charitable activities abroad. Practically speaking, however, this option is open to only a few large and well-established charities, such as relief organizations, which have the financial and administrative resources to send their people abroad.
- Sections 110.1(1)(a) and 118.1(1) of the *Income Tax Act* allow deductions and credits for gifts to the United Nations or any of its agencies, to prescribed foreign universities and to charitable organizations outside Canada to which the Canadian government has made a recent gift. This permits a limited amount of international charitable activity, but the list of eligible donees is very restricted.
- A Canadian charity can enter an agency relation-

ship with an entity, usually a foreign charity, which will do the actual charitable work abroad on behalf of the Canadian charity.

THE TREATMENT OF GIFTS TO REGISTERED CHARITIES AND QUALIFIED DONEES

Gifts

There is no definition of "gift" in the *Income Tax Act*. Therefore, the courts use the private law – i.e., common law or civil law – definition of the term when applying the provisions of the Act. The common law definition of a gift is stated in *Friedberg v. MNR*:[25]

> a gift is a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor.[26]

Similarly, article 1806 of the *Civil Code of Quebec* defines a gift as follows:

> Gift is a contract by which a person, the donor, transfers ownership of property by gratuitous title to another person, the donee; a dismemberment of the right of ownership, or any other right held by the person, may also be transferred by gift.

The Canada Customs and Revenue Agency's position on the meaning of "gift" is set out clearly and comprehensively in Interpretation Bulletin 110-R3, "Gifts and Official Donation Receipts."[27] IT-110-R3 defines a gift as follows:

> A gift ... is a voluntary transfer of property without valuable consideration. Generally a gift is made if all three of the conditions listed below are satisfied:
>
> **(a)** some property – usually cash – is transferred by a donor to a registered charity;
> **(b)** the transfer is voluntary; and
> **(c)** the transfer is made without expectation of return. No benefit of any kind may be provided to the donor or to anyone designated by the donor, except where the benefit is of nominal value.[28]

A gift is a transfer of property, not of services. No donation credit is available for the performance of services rendered without remuneration or compensation.[29] A professional who wants to receive a donation receipt for time and professional skill donated to a charity must first bill the charity for the services performed and then donate the amount he or she is paid back to the charity.

A gift can be a gift of a legal or an equitable interest, so the settlement of a trust which creates an equitable remainder interest in favour of a charity is a gift of that equitable remainder interest.

A loan of property is not a gift of property because no title or right passes by virtue of a loan.

Gifts in kind are gifts of property. A gift in kind is usually valued at the amount that would have been received for the property if it had been sold on the open market to an informed, unrelated party on the date the gift was made.

The transfer cannot be a transfer pursuant to a legal obligation. The Canada Customs and Revenue Agency has recently stated, for instance, that a gift made pursuant to a legal obligation to make it –

e.g., a promise by a child to make a gift of property received by bequest from a parent – is not a gift.[30]

In order to be a gift, property must be transferred to the charity. But the transfer can, in some instances, be subject to conditions and restrictions. This allows for the creation of 'donor-advised' or 'donor-designated' gifts. Restrictions on the uses of the gift can also be imposed through creation of a charitable purpose trust.

The Canada Customs and Revenue Agency does not permit gifts to be directed to specified persons or families. This means that a charity cannot accept a gift on the condition that it gift the property to another person.

A transfer where any part of the transaction can be said to be for consideration usually will not constitute a gift.

EXAMPLE

The Canada Customs and Revenue Agency takes the position that a transfer of land worth $100,000, subject to a mortgage of $25,000, which the charity assumes, may not be a gift because the charity — in assuming liability under the mortgage — may be giving consideration to the donor. Specifically, if the donor has guaranteed the mortgage through a personal covenant, relief from this obligation constitutes consideration.

There are three exceptions to this: in IT-110R3, the Canada Customs and Revenue Agency states that it will permit a charity to issue a receipt for the gift portion of payments made to a charity at a fundraising event, such as a dinner or golf tournament. It takes a similar approach to tuition fees paid for religious education and to charitable gift annuities.

There have been a number of decisions in recent years that have been generally supportive of Canada Customs and Revenue Agency's position. It is worth mentioning one in particular. In *Woolner v. The Attorney General of Canada*,[28] the Federal Court of Appeal found that donations to a church were not gifts. The taxpayers had made contributions to the their church and received charitable donation receipts in exchange. The church used the funds to award educational bursaries to the contributors' children. The Court found that the plaintiffs made their contributions in the expectation that their children would be provided with a bursary, not as a gift to the church.

The treatment of receipted donations

The credit for individuals

Individuals who make donations to registered charities and other qualified donees are entitled to a federal tax credit. This applies to donations of up to 75% of the donor's income in the year. This increases to 100% of the donor's income in the year of death and in the year preceding death. "Cultural gifts" and "ecological gifts" may be used to the entire extent of an individual's income in the year. These are defined terms under the *Income Tax Act.*

The federal credits are equal to 16% on the first $200 donated and 29% on the remainder. Provincial credits vary from province to province, from a high of 24.5% in Quebec to a low of 11.16% in Ontario.

Donation credits may be carried forward five years.[32] The tax credit for gifts made by the taxpayer in the year of death can be carried back to the preceding year to the extent that they cannot be used in the year of death.[33]

Individuals may claim credits for receipts issued in a spouse's name.

Disbursement quotas

Registered charities are required to devote a specific percent of their income to charitable activities or to gifts to qualified donees. Generally speaking, it is accepted that the direct administrative costs of functioning as a charity qualify as charitable activities, but that fundraising costs and legal and accounting costs do not.

The quota for charitable organizations

A charitable organization must spend at least 80% of its previous year's receipted donations on its charitable activities or on gifts to "qualified donees". Twenty percent represents the government's view as to how much of a charitable organization's revenue should be used for non-charitable expenses, such as the cost of administration, fundraising and political activities. The fact that only receipted gifts are included means that gifts from tax-exempt organizations (governments and non-profits) and non-residents and unreceipted gifts do not form part of the pool of gifts required to be disbursed. Gifts from donors who do not require tax receipts are excluded, as are gifts made by way of bequest or inheritance and gifts subject to a trust or a direction that the gifted property (or property substituted) be held for at least ten years.[34] Gifts from one registered charity to another are also excepted.[35] The point of these exceptions is to permit charitable organizations to build up capital endowments with gifts intended for that purpose.

There may be occasions where the disbursement quota cannot be met. In these situations, the charitable organization may apply to the Minister to obtain a discretionary exemption for the shortfall.[36] There is also provision in the *Income Tax Act* for carrying any disbursement quota excess forward five years and back one year.[37] The Minister also allows shortfalls in meeting the disbursement quota in one year to be corrected by increased expenditures the next year.

The quota for public foundations

The quota for public foundations is the total of a number of distinct elements.

- Public foundations must disburse 80% of receipted donations from the preceding year, except for those received as capital gifts or from other charities.
- Public foundations must also disburse 80% of all gifts received from registered charities in the preceding year, except for those received as "specified gifts". The specified gift provision permits tax-neutral transfers of capital between charities. If the donating charity has invoked the specified gift designation, it may not count as part of its own disbursement quota.
- Public foundations must also disburse 4.5% of the average total value of all their investment property, as calculated in a specified way, owned during the preceding twenty-four month period.[38] The underlying expectation is that the foundation should be earning a real rate of return on its investments close to or a bit more than 4.5%. The disbursement quota is calculated so that there is little opportunity for capital growth due to investment earnings over the long term.

The provisions that provide for exceptions to the disbursement quota of charitable organizations at the discretion of the Minister and allow charities to carry forward and back disbursement quota excesses also apply to public foundations.

The quota for private foundations

The disbursement quota for private foundations is the same as that for public foundations except that a private foundation must disburse 100% of the value of its non-specified gifts from registered charities, instead of 80%, as in the case of public foundations.

Quota shopping and disbursement avoidance

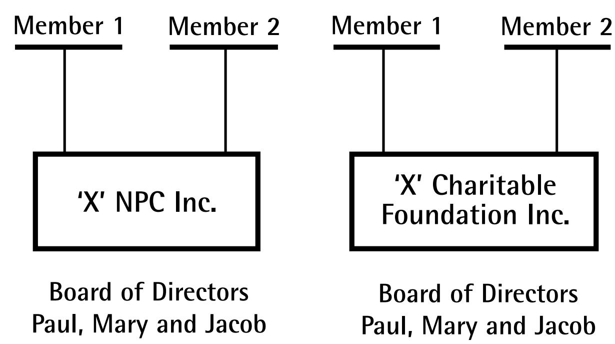
The Minister has the power to designate a charity as being registered in any one of the three classifications.[39] This power is used to prevent a charity from avoiding more onerous disbursement quotas by manipulating the classification system.

CORPORATE STRUCTURES

There are many varieties of planning which can be implemented which address some of the difficulties and challenges presented by the rules governing charities discussed in this chapter.

One common difficulty encountered by some charities is the restrictions placed on charities conducting political activities. The following structure is commonly used to address the difficulty:

FIGURE A



A not-for-profit corporation unable to qualify for charitable status, typically because of advocacy activities, may establish a parallel not-for-profit corporation to carry on the charitable aspects of its mandate (such as education) (Figure A). Each organization would carry on its own activities separately, although it might be possible to share needed space and to share employees. If so, these arrangements must be commercially reasonable such that no plausible argument can be made that the charitable corporation is subsidizing the political corporation's activities.

There are a variety of ways to ensure an appropriate link between the two or control by one of the other. In law, they are autonomous entities and the charity will be required to abide by all the income tax requirements and all the requirements under provincial law. However, through the device of overlapping boards or membership, as illustrated in Figure A, the functions of both corporations can usually be co-ordinated in a satisfactory way.

Another frequently encountered scenario is a charity that wishes to carry on some commercial activity beyond what is permitted under the *Income*

Tax Act. Suppose, for example, that a charity discovers and develops a commercial opportunity in a business that is not related. Provided certain conditions are met, it might be possible for the charity to own the shares of a corporation that carries on the business. That corporation, in turn, could gift or dividend some or all of its income to the charity (Figure B).

a corporation. This rule does not prohibit foundations from being in a position of control by virtue of receiving the shares by gift. In Ontario, the *Charitable Gifts Act* prohibits a charity from owning directly or indirectly more than 10% of a business. To address these difficulties, the structure in Figure C might be used.

FIGURE B

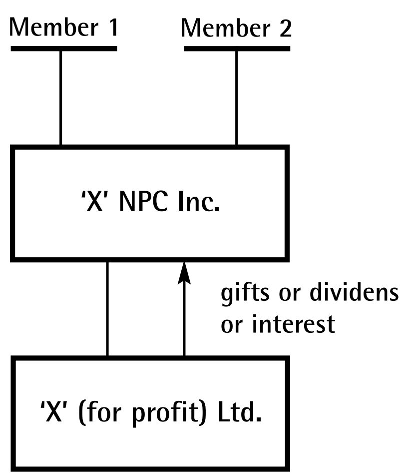
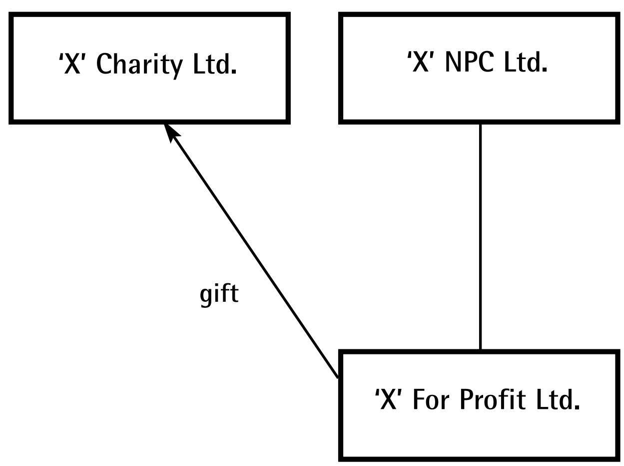


FIGURE C



If the not-for-profit corporation is not a charity, it is taxable on its property income from the for-profit company (dividends and interest, if any) and on its capital gains arising on the sale of the shares of the for-profit company. If the not-for-profit is a charity, it would usually be entitled to issue a donation receipt for any gift made to it by the for-profit corporation.

Foundations (but not charitable organizations) cannot, it will be recalled, acquire control of

The technique of overlapping boards and/or members can be used to ensure that the appropriate level of control is maintained.

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SAMPLE QUESTIONS FOR PROSPECTIVE DIRECTORS TO ASK THE ORGANIZATION

1) What is the tax status of the corporation?
2) What measures are in place to ensure that it makes the necessary Canada Customs and Revenue Agency filings to maintain that status?
3) What measures are in place to ensure that it meets all its other regulatory obligations under the Income Tax Act?
4) If the stakeholders have created an interlocking corporate structure to accomplish their objective(s), has this structure been set up properly, and are there safeguards in place to ensure that any necessary legal distinctions between the various entities are maintained?

SAMPLE QUESTIONS FOR DIRECTORS TO ASK THE ORGANIZATION

1) Are the corporation's tax and information filings up-to-date?
2) Do the corporation's revenue-generating activities comply with the requirements for maintaining its current tax status? Could creating a different type of corporate structure better facilitate this type of activity?
3) Do the corporation's advocacy/political activities comply with the requirements for maintaining its current tax status? Could creating a different type of corporate structure better facilitate this type of activity?
4) If the corporation is a charity, is it meeting its disbursement quota?
5) If the corporation is a charity, does its receipting policy meet Canada Customs and Revenue Agency requirements?

TAXATION CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Tax/Information filings	Full board, audit or finance committee	Annually	Are the corporation's required filings being submitted on a timely basis?
2. Tax status	Full board	At inception of the corporation, and when the mandate of the corporation changes	Does the corporation have the appropriate tax status (registered charity or non-profit) in light of its purposes and activities and given the regulatory requirements associated with the different types of tax status?
3. Non-profit status	Full board	Annually	Is the corporation undertaking any activity that could be considered as conferring a personal monetary benefit on its members?
4. Charitable status	Full board	Annually	Is the corporation meeting its disbursement quota, and complying with regulatory requirements relating to receipting of donations?
5. Revenue-generating activities	Full board	Annually	Do existing or contemplated revenue-generating activities require that a different tax status be sought, or that an interlocking corporate structure be created to facilitate them?
6. Advocacy/ political activitiy	Full board	Annually	Do existing or contemplated advocacy/political activities require that a different tax status be sought, or that an interlocking corporate structure be created to facilitate them?

8

Director Development

Wayne Amundson*
President, Association Xpertise Inc.

INTRODUCTION

Overview

Orientation and training are key to developing a committed and effective board. Boards are encouraged to provide formal orientation to new and current directors, and to include a training component into every meeting. Two important tools can assist in these initiatives – the board manual and the board retreat.

TOOLS

The board manual

The board manual[1] is crucial to the orientation and training of new and current directors. Board manuals should be well planned, well organized and well used.

Initially, the board manual serves as an important orientation tool. It provides new board members (and returning board members) with useful information about the corporation, the board and the staff. For the remainder of the director's term, the manual should be an indispensable tool and central resource about the corporation and the board.

Some of the items that should be included in a board manual are:

- names of board members, their biographies, terms of office and a statement of their responsibilities;
- a list of committees and task forces, with their terms of reference, time frames and membership;
- a brief written history of the corporation and/or a fact sheet about the corporation;
- Letters Patent, supplementary Letters Patent and bylaws;
- mission and vision statements;
- strategic framework or plan, and the current annual operating plan;
- minutes from recent board meetings;
- board policies (e.g., conflict of interest, insurance

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coverage, expense reimbursement);
- the prior year's annual report and audit report;
- current annual budget and latest financial statement;
- banking resolutions and investment policy;
- current list of major funders or partners and/or stakeholder map;
- organizational chart and staff information;
- annual calendar; and,
- promotional material and Web site information.

To be effective, the manual must be current and easy to use. It must allow for materials to be added and removed. Materials included in the manual should have dates on them to make the manual easy to update.

The manual should be organized into clearly marked sections and include a table of contents. It's a good idea to include pockets to hold brochures and similar items. But be selective. The manual should not be a repository for every piece of information about the corporation. It should be of a reasonable size and weight or else directors may not read it and they are less likely to use it as a reference tool. Avoid including duplicate or similar items and, where possible, use summaries instead of longer documents. However, material that has a direct impact on potential liability of directors, such as letters patent or by-laws, should not be summarized. A copy of the manual should be available for reference during meetings.

While the task of developing the manual typically rests with staff, it should be done with input by and in consultation with officers and directors. Board members should regularly evaluate its usefulness and provide suggestions for improvement.

Board retreats

Board retreats help to solidify a not-for-profit board of directors and enhance its effectiveness by giving board members time to get to know each other and to do long-range or strategic planning for the organization. With their packed agendas and the time pressures typically faced by volunteer directors, regular meetings often do not afford opportunity for lengthy discussion and creative thinking. The value of retreats is they remove the board from outside distractions for a sufficient length of time to enable it to contemplate strategic and governance matters, including the board's own development. They may also be an opportunity to draw on outside expertise to help deal with complex governance or corporate issues.

In many organizations having annual board retreats is routine; however, the notion of a board retreat in a not-for-profit corporation frequently resonates poorly with the members and/or the public. Often a retreat is seen as an extravagant expenditure. Where the retreat will be held and how much it will cost, rather than the reason for the retreat, can become the focus of attention and debate. Such concerns should alert directors to the need to be able to justify the merit and cost of a retreat if a member or funder questions how worthwhile the event is.

Evaluation

Boards should allow time at the end of each board meeting to evaluate the meeting and to identify how future meetings could be improved. Boards should also conduct an extensive annual self-evaluation of their own performance and that of the chair. The performance of individual directors should also be evaluated (usually by the chair), and feedback provided to them.

Individual directors can also evaluate their own performance, focusing on their contribution to the board and their own objectives for serving on the board.

Where there are fractious relationships between directors, or the group dynamic as a whole is poor, the board may wish to seek the help of an outside facilitator in conducting the evaluation.

Finally, the board should seek input from members or other stakeholders through surveys and other tools to determine the level of satisfaction with the governance of the corporation.

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SAMPLE QUESTIONS FOR PROSPECTIVE DIRECTORS TO ASK THE ORGANIZATION

1) What orientation documents are provided to directors? Is there a Board manual?

2) What orientation activities and training are provided to prepare directors for their role?

3) Is formal evaluation of the board, and the individual director, undertaken, and is there feedback provided?

SAMPLE QUESTIONS FOR DIRECTORS TO ASK THE ORGANIZATION

1) What are the performance expectations for directors? Are they defined?

2) How am I evaluated?

3) What training is planned to improve Board, and director, performance?

DEVELOPMENT CHECKLIST

SUBJECT	TO BE CONDUCTED BY	HOW OFTEN	COMMENT
1. Review Board Manual	Board chair and executive director	Annually	Feedback from directors who used the manual is essential. The review should focus on contents and usability.
2. Conduct orientation activities	Board chair and executive director	Annually	The needs of new and continuing directors should be considered. The board manual should be used as the basis for the orientation. A retreat is useful given the increased time demands associated with orientation, and the potential need for directors to get to know each other.
3. Training board members	Board chair and executive director, and where needed, outside experts.	Each board meeting	Regular training incorporated into each meeting will complement the initial orientation received at a retreat. To produce effective directors, training is essential.
4. Evaluation	Board chair and members	Each meeting, and annually for board and director performance	Evaluate each meeting and incorporate improvements. Evaluate the performance of the board, the chair and each director. Self-evaluation is also an effective tool to ensure directors' needs are being met.

Endnotes

INTRODUCTION

1 M. Gill, *Governance Do's & Don'ts – Lessons from Case Studies on Twenty Canadian Non-Profits, Final Report* (Ottawa: Institute on Governance, May 2001) at p. 5.

2 *Talking About Charities*, a 2000 public opinion survey conducted by the Canadian Centre for Philanthropy for the Muttart Foundation, found that more than 75% of respondents stated that they have "a lot of" or "some" trust in charities. The survey also found a similar percentage of respondents agreeing that "Charities are Generally Honest About the Way They Use Donations". Copies of complete survey are available on the Muttart Foundation website at *www.muttart.org*.

CHAPTER 1

1 While members are sometimes referred to, in not-for-profit literature, as owners of the organization, this term is generally used in the context of the membership in their role as funder and electorate, as distinguished from their role as consumers of the organization's programs.

2 Industry Canada does not consider the following transfers of money to be pecuniary gain:

- a transfer to a member for the purpose of carrying on activities as an agent of the corporation (e.g., salary payments to an employee who is also a member);
- a transfer to a member charity to carry out the objectives of the corporation;
- a transfer by a corporation that is a registered charity to a member who is a legitimate beneficiary under the corporation's purposes; and,
- a transfer to a member or director for services rendered to the corporation (e.g., payments for services rendered by a supplier who is also a member).

Note, however, with respect to this last point that other not-for-profit corporate law rules may restrict or prohibit a director from dealing with the corporation. See Chapters 2 and 6.

3 At dissolution, unless stated otherwise in the bylaws or other governing documents, the assets of a non-charitable not-for-profit corporation may be distributed to the members. Such payments may be taxable in the hands of the members. Registered charities must transfer their assets to another registered charity or other qualified donee, or face a tax penalty effectively resulting in the forfeiture of all their assets.

4 The specific objects or purpose of the not-for-profit corporation is the basis for its incorporation. It has no power outside these objects. This contrasts with the approach taken in most Canadian jurisdictions to for-profit corporations, where after incorporation they enjoy 'natural person powers' – i.e., the same powers a person has to conduct day-to-day business without a need for any specific authorization.

5 The main cause of this distinction is that, federally and in most provinces, not-for-profit legislation is quite dated. For-profit corporation legislation was modernized across Canada in the 1970s and 1980s. One of many major changes was to simplify the process of incorporation. Under this legislation, all incorporators need to do to create a for-profit corporation is file 'articles of incorporation.' In contrast, not-for-

profit incorporators typically must still apply for 'letters patent of incorporation', which are issued at the discretion of the relevant government agency.

6 This approval process is limited to certain bylaws, and approval is not required if the bylaw addresses an internal matter that has no impact on governance. For example, a bylaw setting out equipment standards or professional conduct criteria would not be subject to review. Bylaw requirements with respect to basic governance issues are found in the *Canada Corporations Act*, s. 155(2). Where a bylaw change relating to governance is proposed, but does not receive Ministry approval, it should not be implemented.

7 While the plural is used for employees, the common practice in not-for-profit entities is for the board to hire the executive director, who hires the other staff.

8 R.S.O., c. C.10

9 *Ibid*. s. 1.(2).

10 See S. Robert, *et al*. eds, *Robert's Rules of Order Newly Revised*, 10th ed. (Perseus: Cambridge, Massachusetts, 2000) at p. 466.

11 For example, the executive director's right to attend board meetings can be set out in the bylaws.

12 H. Kelly & M. Frederick, *Duties and Responsibilities of Directors of Non-Profit Corporations*, (Canadian Society of Association Executives: Toronto, 1999) at p. 32 – note 10.

13 E. Mina, *The Guide to Better Meetings for Directors of Non-Profit Organizations*, (Canadian Society of Association Executives; Toronto, 2000) at p. 29.

14 Final Report to the Panel on Accountability and Governance in the Voluntary Sector in Canada, *Building on Strength: Improving Governance in the Voluntary Sector*, (Ottawa, Feruary 1999) [hereinafter Broadbent Panel]. The tasks are set out on p. 24.

15 The Broadbent Panel's work focused on the voluntary sector. While there was considerable discussion on what organizations constitute this sector, the Panel specifically identified trade associations and professional societies as being outside the scope of its work. While its recommendations and conclusions might apply to the broader not-for-profit sector, the Panel indicated that they were developed for charities and public-benefit organizations.

CHAPTER 2

1 In Québec, this principle is expressed in art. 309 of the *Civil Code of Québec*, which states: "Legal persons are distinct from their members. Their acts bind none but themselves, except as provided by law."

2 *Re: City Equitable Fire Insurance Company Limited*, [1925] 1 Ch. 407 at 428. In Québec, art. 322 of the *Civil Code of Québec* expressly imposes a subjective standard of care ("prudence") on directors of legal persons.

3 *Ibid*. at p. 428.

4 See D. Waters, *Law of Trusts in Canada*, 2d ed. (Carswell: Toronto, 1984) at p. 690.

5 Under Québec civil law, no "breach of trust" exists as such, but directors who direct the corporation to violate the terms of a gift or legacy made to it may be held personally liable for the prejudice caused, under the principles of extracontractual liability set out in art. 1457 of the *Civil Code of Québec*.

6 *Trustee Act*, R.S.O. 1990, c. T.23.

7 H. Picarda, *The Law and Practice Relating to Charities*, 2d ed. (London: Butterworths, 1995) at p. 374.

8 Art. 322 of the *Civil Code of Québec*.

9 This rule is expressly set out at art. 324 of the *Civil Code of Québec*, which requires the director to disclose any interest he has in an enterprise or association that may place him in a situation of conflict of interest.

10 Art. 325 of the *Civil Code of Québec* requires the interested director to disclose his interest to the board of directors and to abstain from the discussion and voting on the question, unless it relates to his remuneration or conditions of employment.

11 *Ibid*.

12 In Québec, see art. 313 and 321 of the *Civil Code of Québec*.

13 *Barrie v. Royal Colwood Golf Club*, (2001) 18 B.L.R. (3d) 21 (B.C.S.C.), at par. 71.

CHAPTER 3

1 *Craik v. Aetna Life Insurance Company of Canada*, [1995] O.J. No. 3286 (Gen.Div.). In Québec this is reflected in art. 309 of the *Civil Code of Québec*.

2 *ADGA Systems International Ltd., v. Valcom Ltd., et al.* (1999), 43 O.R. (3rd) 101 (C.A.). See also, *ScotiaMcLeod et al. v. Peoples Jewelers Limited et al.* (1996), 26 O.R. (3d) 481 (C.A.) at p. 491. Under Québec civil law, directors are liable for their extra-contractual (i.e. tortious) faults against third parties under art. 1457 of the *Civil Code of Québec*, whether or not committed in the execution of their duties. They are not liable for the contractual faults of the corporation (art.

309, 321 and 2160 of the *Civil Code of Québec*) unless they personally commit extra-contractual faults against the contracting third parties.

3 39 E.T.R. (2d) 96.

4 For a detailed discussion on directors' duties to protect charitable assets, see the article by T. Carter, "Pro-active Protection of Charitable Assets – A Selective Discussion of Liability Risks and Pro-active Responses," presented to the Law Society of Upper Canada on November 20, 2001 (available at www.charitylaw.ca).

5 See, *Public Trustee v. Toronto Humane Society* (1987) 40 D.L.R. (4th) 111 (Ont. H.C.); *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626; *Re Faith Haven Bible Training Centre* (1988), 29 E.T.R. 198 (Ont. Surr. Ct.); *Harold G. Fox Education Fund v. Ontario (Public Trustee)* (1989), 69 O.R. (2d) 742;
For more information, please also see article by T. Carter, "Remuneration of Directors in Ontario," available at www.charitylaw.ca.

6 It does not, however, apply in Québec.

7 R.S.O. 1990, c. C-10.

8 For more information on donor restricted gifts, see a paper by T. Carter, "Donor Restricted Charitable Gifts Revisited: A Practical Overview," presented to the Third Annual Estate and Trust Forum of the Law Society of Upper Canada on November 22, 2000, available at www.charitylaw.ca.

9 For more information concerning the requirements of the regulations under the *Charities Accounting Act* (Ontario), see Charity Law Bulletin #4, available at www.charitylaw.ca.

10 R.S.C. 1970, c. C-32.

11 The section imposes personal liability on directors who:
(a) use or authorize any use of a corporate seal purporting to be the seal of the corporation where the name is not legible;
(b) issue or authorize an advertisement or notice or other publication of the company where the corporate name is not legible;
(c) sign or authorize a bill of exchange, promissory note, endorsement, cheque, order for money or goods on behalf of the corporation where the corporate name is not legible;
(d) issue or authorize to be issued any invoice or receipt where the corporate name is not legible.

12 R.S.C. 1985, c. W-11.

13 R.S.0. 1990, c. D.2.

14 *Ibid.*, s. 99(2).

15 R.S.C. c.1 (5th Suppl.) [hereinafter *ITA*]. A similar regime exists in Québec, under s. 24.0.1 ff. of the *Act respecting the Ministère du Revenu*, R.S.Q. c. M-31.

16 *ITA*, s. 227.(1)(1).

17 See, for example, *Moose Jaw Kinsmen Flying Fins Inc. v The Minister of National Revenue*, [1988] 2 C.T.C. 2377 and *Thunder Bay Symphony Orchestra Ass. Inc. v. Canada (Minister of National Revenue – M.N.R.)*, [1998] T.C.J. No. 955.

18 R.S.C. 1985, c. E-5.6.

19 R.S.O. 1990, c. E-11, as am.

20 R.S.C. 1985, c. L-2, as am. S.C. 1993 c. 42.

21 R.S.C. 1985, c. E-15, as am.

22 A director will not be liable for the amount of GST which the corporation failed to remit unless:

- a certificate for the amount of the corporation's liability has been registered in the Federal Court and the debt remains unsatisfied;
- the corporation has started liquidation or dissolution proceedings or has been dissolved and claim for the amount of the debt has been proved within six months after the earlier of the date of commencement of the proceedings or the dissolution; or
- the corporation has made an assignment or a receiving order has been made under the *Bankruptcy and Insolvency Act* and the amount of the debt has been proved within six months after the date of the assignment or receiving order.

23 R.S.C. 1985, c.16 (4th Suppl.).

24 R.S.O. 1990, c. E.19., s 194.

25 R.S.O. 1990, c. C-8.

26 R.S.O. 1990, c. R-23.

27 R.S.A. 1995, c. C-45.

28 R.S.M. 1993, c. 41, s. 10.

29 R.S.P.E.I. 1994, c. 48, s. 4.

30 R.S.C. 1985, c. C-34.

31 R.S.C. 1985, c. P-21.

32 R.S.O. 1990, c. I.8.

33 R.S.O. 1990, c. L.25.

34 R.S.O. 1990, c. S.5.

35 S.C. 2001, c. 41.

36 R.S.C. 1985, c. C-46.

37 For more information of the *Anti-terrorism Act* (Canada) and its application to charities, see Charity Law Bulletins #10 and #11, available at www.charitylaw.ca.

CHAPTER 4

[1] R.S.C. 1970, c. C-32 [hereinafter *CCA*].
[2] Industry Canada, August 22, 2000.
[3] S. 109(1) of the *CCA*.
[4] S. 117 of the *CCA*.
[5] R.S.C. 1985, 5th Supp., c. 1 [hereinafter *ITA*].
[6] S. 230(3) of the *ITA*.
[7] S. 155(2) of the *CCA*.
[8] S. 112 of the *CCA*.
[9] R.S.O. 1990, c. C-10.
[10] S. 149.1(3) and (4) of the *ITA*.
[11] S. 65(2) of the *CCA*.

CHAPTER 5

[1] Industry Canada, Corporations Directorate Policy Summary on Not-for-profit Corporations, Part F, ss. 1-4 [hereinafter Policy Summary].
[2] Though an argument can be made that a "standing committee" must also necessarily be comtemplated in the bylaws, in practice there is no operational difference between a temporary special committee established by board resolution and an on-going committee mandated to deal with, for instance, audit or board nomination matters, through a resolution.
[3] Policy Summary, Part G, ss. 1-7.
[4] See S. Robert, *et al*. eds. *Robert's Rules of Order Newly Revised*, 10th ed. (Perseus: Cambridge, Massachusetts, 2000) at pp. 489-491.

CHAPTER 6

[1] See J. Carver, *Boards That Make a Difference* (Jossey-Bass Inc.: San Francisco, 1990); Also see H.B. Johnson, "Getting on Board: Legal, Ethical, and Practical Considerations for Nonprofit Board Members" (1997) Winter, *Tulsa Law Journal*.
[2] S. 93 of the *Canada Corporations Act*, R.S.C. 1970, c. C-32 [hereinafter *CCA*].
[3] The "wilful neglect" test set out in s. 93 of the *CCA* is not found in s. 124 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. The indemnification bylaw should be drafted to reflect this.
[4] R.S.O. 1990, c. C-38, s. 80.
[5] S. 90 of the *Québec Companies Act*, R.S.Q. c. C-38.
[6] S. 21(3) and s. 157(1) of the *CCA*.
[7] S. 98 of the *CCA*.

CHAPTER 7

[1] *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) [hereinafter *ITA*] The exemption from income tax in favour of registered charities is provided for in para. 149(1)(f). Exemptions from other taxes in the Act - taxes under Parts IV, IV.1, V.1, VI - are provided for in s. 227(14). The exemption from tax under Part 1.3 is provided for in para. 181.1(3)(c). Under para. 149(1)(l) an organization which "in the opinion of the Minister" is not a charity, is exempt from income tax as a non-profit organization. By virtue of this provision, if, in the Minister's opinion, an organization is a charity, it must become registered as one, or else lose its exemption.
[2] The credit for individuals is provided for in s. 118.1 and the deduction for corporations is provided for in s. 110.1.
[3] See Interpretation Bulletin, IT-496R, Non-profit organizations," s. 13.
[4] *Ibid*. s. 8. Directors of not-for-profit corporations should be aware of the distinction between a surplus and a profit, and understand that an entity's non-profit status will not be jeopardized merely because revenues exceed expenses. What constitutes an excessive surplus cannot be stated with certainty, as it will vary from situation to situation. If a significant surplus is characteristic of the corporation's operations or is anticipated, the board may wish to consider setting out a policy on when and/or for what the surplus is to be used.
[5] "Qualified donees" are defined in s. 149.1(1) of the *ITA*.
[6] S. 248(1) "registered charity".
[7] S. 149.1(1).
[8] (1601), 43 Eliz. 1, c. 4. (U.K.).
[9] [1891] AC 531 (HL) (hereinafter *Pemsel*).
[10] [1982] Ch. 321.
[11] *Ibid*. at 332.
[12] *Pemsel*, *supra* note 9 at 583.
[13] S. 149.1(6).
[14] S. 149.1(1) "charitable purposes".
[15] S. 149.1(1) "charitable foundation".
[16] S. 149.1(1) "charitable foundation".
[17] S. 149.1(1) "charitable organization" and "public foundation".
[18] S. 149.1(1) "charitable organization" and "public foundation".
[19] S. 168(1).
[20] S. 172(3).
[21] S. 189.

[22] Para. 149.1(4)(a). Investing in a limited partnership is carrying on a business. See Document 2000-60005475, May 10, 2000.

[23] Information Circular IC87-1, "Reg. Charities - Ancillary/ Incidental Political Activities", February 25, 1987 sets out in more detail the Canada's Customs and Revenue Agency's views on the permissible political activities of a charity. IC87-1 does not define "political activity." It does provide examples.

[24] S. 149.1(1.1).

[25] 89 DTC 5115; [1989] 1 CTC 274 (FCTD) varied 92 DTC 6031; [1992] 1 CTC 1, (FCA) (hereinafter *Friedberg*).

[26] *Ibid*. at 6033, citing *MNR v. Zandstra*, 74 DTC 6416; [1974] CTC 503, per Heald J. at 6419.

[27] Interpretation Bulletin IT 110-R3, "Gifts and Official Donation Receipts", June 20, 1997.

[28] *Ibid*. at para. 3.

[29] *Slobodrian v. MNR*, [1998] 3 CTC 2654 (TCC).

[30] Document 9800525, April 15, 1998.

[31] (1999). 99 DTC 5722; [2000] 1 CTC 35 (FCA).

[32] S. 118.1(1) "total charitable gifts".

[33] S. 118.1(1) "total gifts".

[34] Capital Gains realized from dispositions of the gifted property are, in the view of the Canada Customs and Revenue Agency, substituted property. These are included back into the quota regime in the year in which they are actually expended (s. 149.1(1) "disbursement quota", clause A.1).

[35] S. 149.1(1) "disbursement quota", clause A(c). S. 149.1(4.1) prohibits this exception from being used to delay unduly the expenditure of amounts on charitable activities of a charity. Where that is the purpose of the payment, the Minister may deregister the charities. Thus one charity cannot grant to another, counting the grant towards the satisfaction of its quota, then the recipient charity, in the second year, grant back to the donor, counting the grant towards the satisfaction of its quota, and so on.

[36] This would be available where a charity has had high start-up costs or an unsuccessful and costly fundraising campaign or has not, because of market conditions, achieved its expected rate of return on its investments.

[37] S. 149.1(20).

[38] The calculation of the disbursement quota allows for some flexibility. Reg. 3701 provides that the prescribed amount against which the 4.5% is applied is determined as follows:
(a) choose a number not less than 2 and not more than 8 of equal and consecutive periods that total 24 months and that end immediately before the beginning of the year; (b) aggregate for each period chosen under para. (a) all amounts, each of which is the value, determined in accordance with s. 3702, of the property owned by the foundation and not used directly in its charitable activities or administration on the last day of the period;
(c) aggregate all amounts each of which is the aggregate of values determined for each period under para. (b); and
(d) divide the aggregate amount determined under para. (c) by the number of periods chosen under para. (a). Reg. 3702 provides a series of rules to determine the value of property held by the foundation. S. 3701(3) states that the number of periods chosen by the foundation cannot be changed without the authorization of the Minister. The decision as to the number of periods that a foundation chooses can make a considerable difference in its disbursement quota.

[39] Ss. 149.1(6.3), (13).

CHAPTER 8

[1] This discussion on board manuals focuses on the traditional board manual. In our view, the policy governance manual favoured by adherents to the policy governance model does not eliminate the need for the material contained in a traditional board manual. Their purposes are much different.