

## CHAPTER 2

# Legal Structures for Charitable and Not-for-Profit Organizations

## A OVERVIEW

There are four major legal structures that may be used to establish and operate an association, group, club or similar charitable or not-for-profit organization. These structures are:

- ! *Trusts*. A trust is usually established by a trust document or instrument. The trust document must include three essential components or “certainties” to be recognized by the courts as creating a trust — the certainties of intention, subject matter and object. The trust document typically will set out what the purposes or objects of the trust are, what property is to be held in trust, who the beneficiaries of the trust are or, if a charitable trust, what the criteria are that will be used to determine the beneficiaries or the purpose of the trust, and how the trust property is to be managed by the trustees for the benefit of the specified persons or for the specified purposes;
- ! *Unincorporated associations*. A memorandum of association or similar document sets out the purpose of the organization and how it is to be managed and operated. The memorandum of association is contractual in nature. It does not for most purposes and in most situations create a “legal person” but rather a legal relationship among the members;
- ! *Corporations without share capital*. Letters patent to incorporate a corporation without share capital may be issued under Part III of the *Ontario Corporations Act*<sup>1</sup> or Part II of the *Canada Corporations Act*.<sup>2</sup> A corporation is a separate legal entity or legal person independent of its members, officers and directors. As with any corporation, it needs individuals to act on its behalf to carry out its objects.
- ! *Co-operatives without share capital*. A co-operative is a specialized form of corporation that carries on an enterprise on a co-operative basis. Co-

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<sup>1</sup> R.S.O. 1990, c. C.38 [as am. to S.O. 2001, c. 9, Sched. D, s. 5].

<sup>2</sup> R.S.C. 1970, c. C.32 [as am. to S.C. 1999, c. 3].

operatives are established under the *Co-operative Corporations Act*<sup>3</sup> by articles of incorporation. A co-operative may be either one with share capital, similar to a business corporation, or without share capital and not-for-profit in nature. This text will deal with co-operatives without share capital.

The advantages and disadvantages of each type of legal structure should be assessed in light of the activities and risks of the organization. Are the risks of liability or refusal of funding from potential donors or granting bodies sufficiently high to warrant the costs of incorporation? Is a specific legal structure required to carry out the activities? Are the activities inherently risky or dangerous? How long do the members intend to maintain the legal entity? These questions are largely practical in nature and are concerned with the types of activities the members want to carry out. A legal structure is, ultimately, intended to meet the needs of its members and not third parties.

## **B TYPES OF LEGAL STRUCTURES**

### **I TRUSTS**

Trusts are not common legal structures for most associations and clubs. Trusts may be used to establish a club, but trusts are more commonly used for charitable purposes, for tax purposes or to isolate funds being held by a person for the benefit of another from the assets of the person holding the funds. A typical use, where the potential risk level is normally low, is for the investment and administration of a scholarship or bursary.

A trust is created when one or more persons holds legal title to property, but another person or group of persons has the right to the enjoyment of or to benefit from that property.<sup>4</sup> A trust may arise from:

- ! the words or actions of a “settlor” which indicate an intention to create a trust, either express or implied;
- ! statutes which impose a trust; or
- ! the common law which imposes a resulting or a constructive trust, based on the equities of the situation.

There are three essential characteristics for all trusts, often called the “three certainties”.<sup>5</sup> There must be certainty of intention to create a trust, either by words or actions. The subject matter, the property which is to be the subject of the trust, must be certain. Finally, the objects of the trust must be certain. The

<sup>3</sup> R.S.O. 1990, c. C.35 [as am. to S.O. 2001, c. 8, ss. 6-17].

<sup>4</sup> See, for a fuller discussion of trust law in Canada, Professor D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, Thomson Professional Publishing, 1984).

<sup>5</sup> *Ibid.*, at 107–28.

beneficiary of the trust must be readily apparent or ascertainable by name or class description.

The courts have modified the certainty of object to accommodate charitable activities. Instead of identifying the beneficiaries by name or class description, a charitable trust may include in its objects a purpose for the trust. The charitable purposes should be specific and enable the trustees to determine how the charitable activities are to be carried out. A charitable purpose cannot be vague or ambiguous. It must be certain and determinable in specific fact situations.<sup>6</sup>

The objects clause in a trust document must be carefully prepared. It should provide to the trustees a clear direction on who or what is included in the description of a class of beneficiaries. Trustees for charitable trusts may, however, be given discretion to make a determination about whether or not an individual is one of the intended beneficiaries.<sup>7</sup>

The courts have conferred other significant advantages on charitable trusts that are not applied to other types of trusts. The underlying policy rationale is that charitable trusts provide public benefits. For example, the rule against perpetuities does not apply (with some exceptions with respect to charitable gifts) provided that any gifts vest in the charity within the appropriate time period. The rule against inalienability also does not apply.<sup>8</sup> In order to assist charitable trusts to adapt, the courts will apply the doctrine of *cy-pres*. A charitable trust may apply to the court to change the terms of a trust and use the funds for other, court-approved charitable purposes as close as possible to the original purposes set out in the trust document.<sup>9</sup>

The trustees carry on the activities of the trust in their name as trustees of the trust. For example, the trustees could initiate a legal proceeding in their names as trustees of the trust. The powers and duties of the trustees are set out in the trust document. Trustees also have a number of powers that have been developed by the courts and that have been set out in ss. 17 to 29 of the *Trustee Act*.<sup>10</sup> These powers are administrative and dispositive in nature. For example, s. 21 permits the trustee to purchase insurance to insure property, s. 22 to renew leases, s. 23 to pass the accounts in the Ontario Superior Court of Justice of his or her dealings with the trust property. Sections 26 to 28 provide for investments made by trustees or on their behalf. The revisions in the late 1990s and in 2001 provided a new approach to investment powers, which are discussed in more detail in Chapter 6. Instead of a permitted list of investments, trustees were authorized to make investments in accordance with the prudent investor approach.

The *Trustee Act* may be used to supplement the powers and duties of trustees; however, where possible, all of the trustees' major powers and duties should be

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<sup>6</sup> See, for a fuller discussion of this point, Part D, "What is 'Charitable'?" in Chapter 1.

<sup>7</sup> *Jones v. T. Eaton Co.*, [1973] S.C.R. 635.

<sup>8</sup> See Professor D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, Thomson Professional Publishing, 1984) for a fuller discussion of these legal issues. The rule against perpetuities and the rule against inalienability are too complex to discuss in any detail in this text.

<sup>9</sup> The doctrine of *cy-pres* is discussed in more detail in Chapter 9, "Supervision of Charitable Organizations".

<sup>10</sup> R.S.O. 1990, c. T.23 [as am. to S.O. 2001, c. 9, Sched. B, s. 13].

clearly set out in the trust document. The trust document will usually be more familiar to trustees than the Act will be. The *Trustee Act* should not be relied upon to fill in the gaps in the trust document. It is often not sufficiently flexible to take into account the different types of purposes or methods of operation that many organizations want or need. The unique characteristics of an organization and how the trustees are to carry out the objects and purposes of the trust should be built into the trust document.

The relationship between the trustees and the charitable trust and its beneficiaries is a fiduciary one. The trustee has substantial obligations that arise out of this fiduciary relationship. Three basic duties have been imposed by the courts on trustees. First, a trustee must carry out his or her tasks honestly and with due care and attention. Second, the trustee must carry out the duties personally and not delegate to another person the responsibilities entrusted to him or her. There are exceptions to this duty — where the trust document permits delegation, for certain administrative matters and where otherwise authorized by law, such as the *Trustee Act*. Third, the trustee must place the interests of the beneficiaries or the purpose of the charitable trust first and not permit his or her own interests to conflict in any way with the duties to the beneficiaries or the purpose of the charitable trust.<sup>11</sup>

## II UNINCORPORATED ASSOCIATIONS

An unincorporated association is a relatively common legal structure for a group of persons to use. It is, essentially, an agreement among a number of persons which articulates their common purpose, establishes an organization to achieve that common purpose and sets out how that organization is to be operated to achieve that purpose. The relationship among the persons is contractual in nature. The courts sometimes refer to these organizations as “voluntary associations”.<sup>12</sup>

An organization is made up of “members” who agree, implicitly or explicitly, with the common purpose. Usually, the members are intended to receive some benefits from being members. This intent to benefit the members distinguishes an unincorporated association from a trust, which is usually, but not invariably, intended to benefit other persons or for specified purposes, in the case of some charitable trusts.

An association is not limited in the scope of its objects, provided that they are lawful objects. In contrast, a charitable trust must have only objects that are charitable in nature; and corporations without share capital cannot, for example, have any objects that suggest that the organization is a government entity. The association, therefore, is the most flexible organizational model because there are no restrictions on its objects, provided that they are not otherwise prohibited by law.

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<sup>11</sup> These duties are examined in more detail in Chapter 6, “Officers, Directors and Trustees: The Standards of Care”.

<sup>12</sup> *Orchard v. Tunney*, [1957] S.C.R. 436, 8 D.L.R. (2d) 273.

The organization may be set up formally or informally, depending upon the needs of the members. Associations may also evolve out of a relationship among a few individuals and, over time, take on the formal characteristics of an association. At the informal level, the relationship may be based on an “understanding” but later on a written constitution or by-laws are developed.

An association has some of the characteristics of a partnership but it is not one. A partnership is established with the intent of carrying on business and making a profit. An association may be used to discuss commercial matters, but its purpose is not to carry on business activities or to make a profit. In *Ottawa Lumbermen’s Credit Bureau v. Swan*<sup>13</sup> the Court dealt with an organization that had an office and an employee and carried out credit negotiations for its members. The members contributed to a fund to pay the expenses of the organization, which included gathering information. The Court commented that:

The members, therefore, act in common in gathering information, but it seems to be straining the words to call that carrying on business in common; and it seems to be straining them still more to call it carrying on business in common with a view of profit; for in what is done there is no idea at all of profit or advantage of any kind to the bureau — the only profit that there can possibly be is a profit (or an avoidance of loss) to the individual members in their individual businesses. Therefore I think that there is here no partnership in the proper sense of the term.

The courts have taken a similar approach in defining trade unions as voluntary associations.<sup>14</sup>

### III ONTARIO CORPORATIONS AND CO-OPERATIVE CORPORATIONS WITHOUT SHARE CAPITAL

#### (1) Corporations without Share Capital

The objects of a corporation without share capital incorporated under the Ontario *Corporations Act*<sup>15</sup> are very broad. Section 118 permits a corporation to be incorporated under Part III of the Act where it “has objects that are within the jurisdiction of the Province of Ontario”. Corporations without share capital are incorporated for non-profit purposes and not for business purposes. Some may also be charitable in nature.

There are five basic types of non-profit corporations under the Act:

- ! general, such as neighbourhood associations, trade or business associations, community organizations and so forth,
- ! sporting and athletic organizations. If the organization is involved in the use of firearms, there are federal registration requirements for firearms

<sup>13</sup> (1923), 53 O.L.R. 135 (C.A.).

<sup>14</sup> *Metallic Roofing Co. of Can. v. Amalgamated Sheet Metal Workers Intn’l Assn., Local 30*, (1905), 9 O.L.R. 171 (C.A.).

<sup>15</sup> R.S.O. 1990, c. C.38 [as am. S.O. 1994, c. 27, s. 78(5)].

and other requirements to ensure that the firearms are kept and used in a safe manner. Consultation with the appropriate law enforcement agency is recommended. If the organization is involved in organized sports, a number of associations are in place at the municipal, school board, provincial and national levels to ensure that there is appropriate safety and training in place for the sport or athletic activity. These associations of sporting organizations may also be representative of the sport to governments and international associations and membership in them may be necessary to participate competitively in the sport or athletic activity,

- ! social clubs, where the objects of the corporation are in whole or in part social in nature,
- ! service clubs, such as Knights of Columbus, Optimists, Rotary and so forth. If the corporation is to be affiliated with an established service club, permission from the parent is usually required. The use of the names of most of service clubs is protected as it is the intellectual property of those organizations. In addition, without the written permission to use the name, any proposed name would likely be seen as deceptively similar and not approved,
- ! charities, including religious organizations and other organizations whose objects are charitable.

Incorporation is usually a simple process, provided that the members have taken the time to review what they want. The process may take several weeks to several months from application to receipt of letters patent. The time period will depend in part on the application's completeness, whether or not there are any backlogs, whether or not the appropriate pre-clearances, approvals or reviews have been obtained, and whether or not changes to the application are necessary.

The costs of incorporation will include disbursements and fees of between \$300 and \$500, depending upon the need for government approval, and legal fees. The level of legal fees will depend upon the need for legal advice and services to meet the member's objectives and to obtain government approval. A relatively simple non-profit organization could be incorporated for about \$1,000 to \$1,500; however the actual costs in disbursements, fees and legal services will vary.

There are three major steps to the incorporation process: name search, submission of the application and receipt of the letters patent, and establishing the corporation. Each of these three steps is discussed in Chapter 3, "Incorporating a Charitable or Not-for-Profit Organization".

A number of corporations may have activities that are either regulated for public safety and protection or are related to various government programmes. If the corporation is intended to carry on activities that are regulated or intended to benefit from these programmes, it would be appropriate to consult with the relevant government ministry or agency. The Ministry of Consumer and Business Services previously circulated applications to relevant ministries within the Government of Ontario, but that practice ceased in 1993. In some cases, the government has also abandoned programme areas, such as social housing, where prior approvals were required from the relevant ministry or it had specific re-

quirements in the letters patent and other documentation before the corporation would be eligible to benefit from the programme.

The Ministry of Community and Social Services provides funding for and regulates a number of services provided to members of the public. These services include nurseries, child care, child and family services, services for persons with disabilities and services for seniors. Where a corporation applies for a licence under the *Day Nurseries Act*,<sup>16</sup> the *Elderly Persons Centres Act*,<sup>17</sup> the *Charitable Institutions Act*<sup>18</sup> or similar legislation, or for funding under a ministry programme, the incorporators should consult with the Ministry.

The *Charitable Institutions Act* should be reviewed where the corporation will provide residential, sheltered or specialized or group care in buildings maintained and operated by the corporation. Several types of institutions are exempted from the Act where other more specific legislation applies. If the Act does apply, the approval of the Minister of Community and Social Services is required before the corporation operates the services. The Act and its regulation are detailed and provide significant legal obligations on the corporation and its officers and directors. Both should be reviewed if the corporation intends to carry on activities under the Act.

The Ministry of Health regulates the provision of health services and facilities in Ontario. In some cases, the prior approval of the Minister of Health is required before the letters patent may be issued. Section 4(1) of the *Public Hospitals Act*<sup>19</sup> requires the Minister's approval prior to the issuance of the letters patent, as does s. 7 of the *Ambulance Act*.<sup>20</sup> Section 5 of the *Private Hospitals Act*<sup>21</sup> prohibits the incorporation of a corporation under the *Corporations Act* or the *Business Corporations Act*. It is prudent, where the corporation will be providing health services or facilities, to review a draft of the application for letters patent with the Ministry of Health.

The Ministry of Training, Colleges and Universities administers the *Post-Secondary Education Choice and Excellence Act, 2000*,<sup>22</sup> the *Private Vocational Schools Act*,<sup>23</sup> and the *Ministry of Training, Colleges and Universities Act*.<sup>24</sup> A letters patent corporation that is intended to provide educational or training services may fall within those statutes. The prior written approval of the Minister is required if the corporate name is to include the terms "university", "college" or "institute".<sup>25</sup> The Ministry's major concern is to ensure that members of the public are not misled with respect to any private college or institute.

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<sup>16</sup> R.S.O. 1990, c. D.2.

<sup>17</sup> R.S.O. 1990, c. E.4.

<sup>18</sup> R.S.O. 1990, c. C.9.

<sup>19</sup> R.S.O. 1990, c. P.40.

<sup>20</sup> R.S.O. 1990, c. A.19.

<sup>21</sup> R.S.O. 1990, c. P.24.

<sup>22</sup> S.O. 2000, c. 36, Sched.

<sup>23</sup> R.S.O. 1990, c. P.26.

<sup>24</sup> R.S.O. 1990, c. M.19 [as am. to S.O. 2001, c. 6 and c. 8].

<sup>25</sup> O. Reg. 181/90, subs. 3(1).

The Ministry of Municipal Affairs administers the *Community Economic Development Act, 1993*.<sup>26</sup> That Act provides for the incorporation of two types of community economic development corporations: community investment share corporations (CISC) and community loan fund corporations (CLF). A CISC is intended to assist communities in developing and diversifying their local economies. Investors purchase shares in a community-based CISC and the funds are invested in shares of a new or expanding eligible business in the community. A CISC is, however, a for-profit business, usually incorporated under the Ontario *Business Corporations Act*<sup>27</sup> or the *Co-operative Corporations Act*<sup>28</sup> as a corporation or co-operative corporation with share capital.<sup>29</sup>

Community loan fund corporations are incorporated as non-profit corporations under the *Corporations Act* (or non-profit co-operative corporations under the *Co-operative Corporations Act*) to establish, finance and operate a community fund. The fund provides collateral loans to eligible borrowers. It may also provide business and other advice to these borrowers. The intent is to encourage the establishment and growth of small businesses in a community by providing loans to those businesses that lack the assets to secure a loan. The CLF provides the loan guarantee to an entrepreneur who uses the guarantee to obtain a loan from a financial institution that is in partnership with the CLF. The funds to provide the guarantee are raised from investors, pooled and then reinvested in safe investments. A wide variety of non-profit or government organizations may sponsor a CLF.<sup>30</sup>

An increasing number of Aboriginal organizations have incorporated corporations without share capital in order to be eligible for government funding or to assist in administering the programmes through Aboriginal controlled organizations. Incorporation may be a condition for grants and other support from various government programmes. Corporations without share capital have been established to provide not-for-profit housing, job and skills training, economic development (including infrastructure and corporations to operate local airports), social development and the delivery of programmes previously provided directly by the federal government.

The corporate form is a useful approach to establish a mechanism for Aboriginal organizations to control the administration of programmes. The objects of a corporation without share capital may not be political in nature. This form of legal entity should not be used to establish, for example, the “government” for a First Nation because governments are political in nature. It could be used, however, to establish one of the mechanisms through which a government may operate.

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<sup>26</sup> S.O. 1993, c. 26.

<sup>27</sup> R.S.O. 1990, c. B.16.

<sup>28</sup> R.S.O. 1990, c. C.35.

<sup>29</sup> *Community Investment Shares Program Handbook* (Ontario: Ministry of Municipal Affairs, 1994).

<sup>30</sup> *Community Loan Fund Program Handbook* (Ontario: Ministry of Municipal Affairs, 1994).

## (2) Co-operative Corporations without Share Capital

A co-operative corporation is a specific type of corporation established by articles of incorporation under the *Co-operative Corporations Act*. Section 1 of that Act defines “co-operative” as a corporation “carrying on an enterprise on a co-operative basis”. “Enterprise” is not a defined term but would appear to include both business or commercial activities and noncommercial activities. A co-operative may, however, be either a corporation with share capital or without share capital. A co-operative with share capital is more in the nature of a business corporation. This text will focus on co-operatives without share capital, which are similar in intent to corporations without share capital under the *Corporations Act*.

A co-operative is organized, operated and administered upon certain principles and methods. These principles and methods are set out in s. 1 of the Act. Each member has only one vote and no member may vote by proxy. The enterprise is to be operated as nearly as possible at cost after providing for reasonable reserves. Any surplus funds, unless used to maintain or improve services of the organization for its members, are to be distributed to the members, unless the co-operative corporation is to be charitable in nature. Surplus funds may also be donated for community welfare or for the propagation of co-operative principles.

The co-operative legal structure has been used for the distribution of goods to members or to provide specialized services to members. For example, co-operatives have been established to provide farming supplies in rural areas, outdoors equipment to campers and hikers, and farm-fresh food to urban dwellers. Essentially, these types of co-operatives purchase in bulk and sell to members at a price that they would not be able to obtain on their own.

Co-operatives have also been popular methods for non-profit housing. In 1992, Ontario enacted amendments to the *Co-operative Corporations Act* to ensure that non-profit co-operative housing, which receives substantial benefits from the government, cannot be transformed into for-profit housing. The amendments set out mandatory provisions for their articles for all non-profit housing co-operatives, which are related to providing housing on a non-profit basis to the members. The Ontario Government, a few years later, abandoned its role in social housing, which substantially reduced if not eliminated the creation of not-for-profit housing co-operatives.

The amendments also permitted multi-stakeholder co-operatives. In a multi-stakeholder co-operative, control is shared among two or more distinct stakeholders, each of whom may have different interests. They work together on a co-operative basis and, at the same time, their respective interests are reflected in the operations of the co-operative. Each stakeholder, for example, will elect its own directors and must approve changes to the articles of incorporation or by-laws.

#### IV FEDERAL CORPORATIONS WITHOUT SHARE CAPITAL

Incorporation under Part II of the *Canada Corporations Act*<sup>31</sup> is appropriate where the organization will operate on a national level or in more than one province, or if the objects and activities fall within federal constitutional jurisdiction. If the objects and activities fall within provincial jurisdiction, the applicants should also consider incorporation under the Ontario statute and then obtain registration to operate as an extra-provincial corporation in other appropriate provinces.

Some incorporators of charitable corporations in Ontario prefer to incorporate under the federal legislation where possible. This approach avoids the need for prior approval or review by the Public Guardian and Trustee. It was thought by some that the process caused delays and unnecessary complications. However, the Public Guardian and Trustee has amended its procedures, including the development of pre-approved object clauses for corporations without share capital, to reduce the time required for incorporation.

The federal Act provides for similar types of corporations as does the Ontario statute but is not as specific as is the Ontario legislation. A corporation without share capital may be a not-for-profit corporation that provides services to its members, such as a professional association. It may also be a not-for-profit corporation with charitable objects that does not intend to register as a charitable organization. Finally, the corporation may be a charitable corporation that does intend to register its charitable status.

Is a corporation that is charitable in nature required to notify the Public Guardian and Trustee of its existence under the *Charities Accounting Act*?<sup>32</sup> Although there may be an argument that it is not required to do so, it would appear that the Public Guardian and Trustee does claim jurisdiction over federally incorporated charitable corporations that carry on activities in Ontario.

Industry Canada is responsible for the administration of the *Canada Corporations Act*. Corporations without share capital are incorporated under Part II of that statute. The Department developed an information kit to assist applicants for incorporation under Part II.<sup>33</sup> The kit includes a sample application, model by-laws, a summary of the Department's policy on not-for-profit corporations, a checklist for use with the application and a fee schedule. A handbook is also being prepared to assist in the incorporation process.

The kit is intended to assist applicants in several ways. First, it sets out the requirements for incorporation under the Act. The policy summary also provides information on what is acceptable under the Act, including areas where the Act is not clear. Second, the use of the model by-laws will speed up the process for incorporation. The model by-laws include provisions on all the areas that must be in the by-laws under Part II of the Act. Adoption of the model by-laws avoids the need for departmental review of the by-laws. Where changes to the model

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<sup>31</sup> R.S.C. 1970, c. C.32.

<sup>32</sup> R.S.O. 1990, c. C.10.

<sup>33</sup> Industry Canada, "Information Kit on the Creation of Non-Profit Corporations", November 25, 1999.

by-laws are necessary, the list of requirements assists applicants to ensure compliance with the Act and the Department's policies. Third, the information kit provides information to applicants to understand the process of incorporation and the maintenance of a corporate entity.

Industry Canada consulted the sector in 2000 and 2001 on proposed changes to the incorporating legislation and processes. It is anticipated that legislation will be introduced that will permit "as of right" incorporation of corporations without share capital. The corporations would have objects clauses but would have broader powers, subject to appropriate limitations given the nature and purposes of these corporations. The legislation, it is expected, will also deal with matters that are absent in the existing statutory scheme, confusing or obstacles to the use of federal corporations without share capital.

## C ADVANTAGES AND DISADVANTAGES OF THE LEGAL STRUCTURES

### I INTRODUCTION

The practical purposes for all four legal structures are to establish the organization and to provide for the rules of its operation. The choice of legal structure will depend upon the situation of each group. Each type of structure has its own legal and practical advantages and disadvantages. These advantages and disadvantages should be assessed in light of the particular circumstances of each group. This section discusses briefly the benefits and advantages of the different legal structures.

It is important to assess the particular circumstances of a group, its purpose and its expected activities and operations before deciding on which of the four legal structures is appropriate. The Initial Information Checklist may assist in making this assessment.

Some regulators require an organization to be incorporated. Additionally, the federal *Income Tax Act* seems to encourage corporate entities over unincorporated associations. Corporations without share capital may be exempt from taxation pursuant to subs. 149(1) of that Act, but income of an unincorporated association may be taxable in the hands of each member. A "club, society or association" may qualify under para. 149(1)(l) for an exemption from income taxation. The exemption may not, however, apply to any income from property owned by the club, society or association.<sup>34</sup>

The trust structure is not, in itself, expensive to establish or to operate. It is not usually a useful structure where the organization intends to own or lease real estate (such as a sports facility), enter into a number of contractual relationships, or if it will be exposed to a significant risk of liability arising from its operations

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<sup>34</sup> See, for a fuller discussion of this issue, the following two Interpretation Bulletins issued by the Canada Customs and Revenue Agency — "Non-profit Organizations," IT-496R, August 2, 2001 and "Non-profit Organizations — Taxation of Income from Property," IT-83R3, October 31, 1990.

and transactions. It is useful where the trustees are primarily to hold and invest funds or other similar property and to disburse the income from those funds or other similar property.

In comparison to other legal structures, the trust may increase the potential exposure of trustees. The obligations of a trustee are substantial. A trustee must:

- ! carry out his or her tasks with due care and attention and honesty;
- ! carry out the duties personally and not delegate to another the responsibilities entrusted to him or her; and
- ! place the interests of the beneficiary first and not permit his or her own interest to conflict in any way with the duties to the beneficiary.

Although these duties are similar in nature to the duties of a director of a corporation without share capital (especially a “charitable corporation”), the standard of care appears to be higher for trustees, in particular trustees of a charitable trust, than for directors and officers of a corporation or even of an unincorporated association. Trust law is also generally more complicated and may be difficult to understand for trustees who are not legally trained.

## II LIABILITY OF MEMBERS

The basic legal difference between an unincorporated association and a corporation without share capital is not their purposes, but their legal characters. A corporation is a separate legal entity. An unincorporated association is not a separate legal entity and it usually has no legal status apart from that of its members. The members may, therefore, be held individually liable for the actions of the unincorporated association.

Members of an incorporated organization are in a different legal position. Under s. 122 of the *Ontario Corporations Act*:<sup>35</sup>

A member shall not, as such, be held answerable or responsible for any act, default, obligation or liability of the corporation or for any engagement, claim, payment, loss, injury, transaction, matter or thing relating to or connected with the corporation.

Section 73 of the *Co-operative Corporations Act* has similar wording that limits liability of the members in their capacity as members of the co-operative.

By contrast, plaintiffs may properly look to the officers, directors or members of an unincorporated association for compensation for breach of contract, negligence or tortious actions in a number of situations. For example, the officers, directors and members of an unincorporated association may be liable where

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<sup>35</sup> R.S.O. 1990, c. C.38. A comparable section is not found in the *Canada Corporations Act* but see para. 21(1)(d) of the *Interpretations Act*, R.S.C. 1985, c. I-21.

they assumed to act for the association, authorized or sanctioned a contract or otherwise led the plaintiff to believe that the contract would be honoured.<sup>36</sup>

It is probably prudent to advise clients that all of their personal assets are potentially exposed to meet contractual or tortious liabilities of an unincorporated association. The cases are, however, confusing and, at times, contradictory. The courts appear to have attempted to address the issues on an equitable basis, but this is far from certain. Additionally, the reported cases tend to come from certain specific fact situations involving fraternal societies (which provide insurance or similar benefits to members) or unions. The reported cases are also usually older cases, from the late nineteenth and early twentieth centuries. There are only a few modern cases that appear to deal with these issues.<sup>37</sup>

### III LEGAL CAPACITY

An unincorporated association is not usually recognized in law. In common law, unincorporated associations cannot be sued or sue in their own names.<sup>38</sup> They cannot assert, for example, any position that is maintainable in law only by a legal entity. As a result, an unincorporated association is not legally recognized as a landlord or a tenant<sup>39</sup> and it cannot validly endorse a note to pass title.<sup>40</sup> A lease or an endorsement must be signed by all members of the association or, in some circumstances, the trustees. Any property rights that it has are to be held according to the rules of the association; but the property continues to be property of the members of the association.<sup>41</sup> It may maintain an action by a representative if the rules of court permit it to do so.<sup>42</sup> It also may not have legal status to appear before certain administrative law tribunals.<sup>43</sup> For example, an

<sup>36</sup> *Finlay v. Black* (1921), 60 D.L.R. 422, [1921] 2 W.W.R. 907 (Y.T. S.C.); *Aikins v. Dominion Live Stock Assn. of Canada* (1896), 17 P.R. 303 (Ont. Div. Ct.).

<sup>37</sup> For a good discussion of the liability issues for tort and fiduciary matters, see Robert Flannigan, "The Liability Structure of Nonprofit Associations: Tort and Fiduciary Liability Assignments", [1998] 77 Cdn. Bar Rev. 73.

<sup>38</sup> *Comeau v. Fundy Group Publications Ltd.* (1981), 24 C.P.C. 251 (N.S. T.D.). See also *Cummings v. Ontario Minor Hockey Assn.* (1979), 26 O.R. (2d) 7, 104 D.L.R. (3d) 434, 10 R.F.L. (2d) 121 (C.A.).

<sup>39</sup> *Can. Morning News Co. v. Thompson et al.*, [1930] S.C.R. 338, [1930] 3 D.L.R. 833; *Henderson v. Toronto General Trusts Corp.*, [1928] 3 D.L.R. 411 (Ont. C.A.); *Ottawa Lumbermen's Credit Bureau v. Swan* (1923), 53 O.L.R. 135, [1923] 4 D.L.R. 1157 (C.A.). But see *Watkins v. Hamilton-Wentworth C.C.F. Council*, [1947] O.W.N. 791 (Co. Ct.) where a lease was signed by two individuals on behalf of three political unincorporated associations. The associations, in that case, could be sued properly in action for possession.

<sup>40</sup> *Cooper v. McDonald* (1909), 11 W.L.R. 173, 19 Man. R. 1 (C.A.).

<sup>41</sup> *Wawrzyniak v. Jagiellicz* (1988), 65 O.R. (2d) 384, 51 D.L.R. (4th) 639 (C.A.), affg. (1988), 64 O.R. (2d) 81, 48 D.L.R. (4th) 688 (H.C.).

<sup>42</sup> *McDonald v. Linton*, 53 N.B.R. 107, [1926] 3 D.L.R. 779 (C.A.); *Blackfoot Stock Assn. v. Thor*, [1925] 3 W.W.R. 544 (Alta. C.A.).

<sup>43</sup> *Ladies of the Sacred Heart v. Armstrong's Point Assn.* (1961), 29 D.L.R. (2d) 373, 36 W.W.R. 364 (Man. C.A.). See *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, subs. 1(2), which defines party for administrative tribunals.

unincorporated association, other than an association of employers or a union, is not a party in a proceeding before the Ontario Municipal Board.<sup>44</sup>

There are exceptions to the general rule. In the field of organized athletic activities, the law recognizes that an association may be named as a party to an action.<sup>45</sup> There may also be exceptions to the general rule where the organization is provided for under other statutory provisions. For example, if the organization includes a statutory trustee, the organization could probably be sued with respect to matters coming under that statutory trust. The basis for this approach appears to be that the statute creates an artificial person or quasi-corporation that may sue or be sued.<sup>46</sup>

An unincorporated association may still be more restricted in maintaining a legal action. For example, an illegal object or an object that is contrary to public policy may mean that an unincorporated association cannot maintain a civil action in Ontario.<sup>47</sup> If an illegal object can be severed, the civil action could be maintained.<sup>48</sup>

#### IV RELATIONSHIP AMONG MEMBERS

Generally, membership creates a contractual relationship between each member in an unincorporated association.<sup>49</sup> The terms of that contractual relationship will be found in the constitution adopted by the membership. Unless the contract provides otherwise, the terms of the contract as set out in the memorandum of association may not be altered unless all members agree to do so. However, rules or by-laws that are established by the directors, officers or a majority of the members probably could be amended in the same way as they were established if there are no amending provisions for rules and by-laws. If the rules or by-laws were not contractual in nature and were, for example, enacted by a majority of the directors to govern behaviour at meetings, the rules or by-laws could probably be amended by a majority of the directors.

As with any contractual relationship, a breach of the contract may give rise to damages and to a cause of action. A violation of the rules, however, will not necessarily give rise to a cause of action if there was no deliberate attempt to violate the rules.<sup>50</sup>

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<sup>44</sup> See R. 1.03, *Rules of Procedure*, R.R.O. 1990, Reg. 889, under the *Ontario Municipal Board Act*, R.S.O. 1990, c. O.28.

<sup>45</sup> *Warkentin v. Sault Ste. Marie (Board of Education)* (1985), 49 C.P.C. 31 (Ont. Dist. Ct.).

<sup>46</sup> *Trustees of Greek Catholic Ruthenian Church of East Selkirk v. Portage LaPrairie Farmers Mutual Fire Insurance Co.*, 31 D.L.R. 33, [1917] 1 W.W.R. 249 (Man. C.A.). See also *Metallic Roofing Co. of Can. v. Amalgamated Sheet Metal Workers' Intn'l Assn., Local Union No. 30* (1903), 5 O.L.R. 424 (Div. Ct.), affd. (1905), 9 O.L.R. 171 (C.A.) and *Centre Star Mining Co. v. Rossland Miners Union* (1902), 9 B.C.R. 190 (S.C.).

<sup>47</sup> *Polakoff v. Winters Garment Co.* (1928), 62 O.L.R. 40, [1928] 2 D.L.R. 55 (H.C.).

<sup>48</sup> *Chase v. Starr*, [1924] S.C.R. 495, [1924] 4 D.L.R. 55, 44 C.C.C. 358.

<sup>49</sup> *Stephen v. Stewart* (1943), 59 B.C.R. 410, [1944] 1 D.L.R. 305, [1943] 3 W.W.R. 580 (C.A.); *Foran v. Kottmeier*, [1973] 3 O.R. 1002, 39 D.L.R. (3d) 40 (C.A.).

<sup>50</sup> *Temple v. Hallem* (1989), 58 Man. R. (2d) 54, 58 D.L.R. (4th) 541, [1989] 5 W.W.R. 660 (C.A.).

## V ADVANTAGES OF UNINCORPORATED ASSOCIATIONS

There are a number of advantages to unincorporated associations. Unincorporated associations are usually easier to establish. For example, they do not usually require the approval of any government body as do corporations without share capital. The major exceptions are if the activities of the unincorporated association are regulated or if it is or is intended to be a charitable organization.

Unincorporated associations have few reporting requirements. They do not, for example, need to make any corporate filings as do corporations under the *Corporations Information Act*,<sup>51</sup> the *Co-operative Corporations Act*<sup>52</sup> and the *Canada Corporations Act*.<sup>53</sup>

Unlike trust or corporate law, the courts have not been extensively involved in reviewing unincorporated associations and their activities. There are few statutory provisions that are specifically intended to apply to unincorporated associations. As a result, while there is more flexibility in how unincorporated associations operate, there is also the potential for greater uncertainty. For example, there are no statutory requirements for the directors to provide to the membership the organization's financial statements. Under the *Corporations Act*,<sup>54</sup> directors of corporations without share capital are required to present to the membership the corporation's financial statements and the report of the auditor. The directors of a co-operative corporation must also present the co-operative's financial statements to the members. In trust law, trustees are required to account for the property being held in trust.

The absence of "fixed" rules provides greater flexibility to members to organize their relationship. An organization may be tailored very carefully to the needs and wants of its members. But it also means that the members, officers, directors and courts have few reference points to assist them when disputes arise or there is a need for an unanticipated change. For example, because the relationship is contractual in nature, absent a provision for amendments in the Memorandum of Association, all members must agree to a change in the relationship. To avoid the need for unanimity, the Memorandum of Association could set out the procedures and requirements for amendments, i.e., by resolution approved by a majority of the members voting at a meeting called for that purpose. It could also include the procedures and requirements for the dissolution of the organization, including what happens to any assets and liabilities. However, rules or by-laws that are established by the directors, officers or majority of the members probably could be amended through a similar procedure.

The lack of a statutory base for unincorporated associations means that any by-laws or rules must be based on the objects of the organization. The by-laws and rules may not be *ultra vires* the objects of the organization as set out in the Memorandum of Association or similar constating document.<sup>55</sup> The Ontario

<sup>51</sup> R.S.O. 1990, c. C.39.

<sup>52</sup> R.S.O. 1990, c. C.35.

<sup>53</sup> R.S.C. 1970, c. C.32.

<sup>54</sup> R.S.O. 1990, c. C.38, s. 97.

<sup>55</sup> *Matheson v. Kelly* (1913), 15 D.L.R. 359, 5 W.W.R. 950 (Man. K.B.).

*Corporation Act* provides explicitly for the types of matters that may be in the by-laws<sup>56</sup> as does the *Co-operative Corporations Act*.<sup>57</sup>

Unincorporated associations are often less expensive to establish than corporations. For example, because no application is usually required, no application fees need to be paid. The lower costs to establish the organization may be an important factor in deciding whether or not to incorporate. In addition, because approval of the government is usually not necessary, they can be established faster than corporations.

The level of risk is also a factor in deciding whether or not to incorporate or operate as an unincorporated association. A major reason to incorporate an association or club is to minimize the risk of members' liability. As noted above, s. 122 of the *Corporations Act* and s. 73 of the *Co-operative Corporations Act* significantly minimize the risks of liability. However, not all activities give rise to a significant level of risk. The risk can also be minimized by other means, such as requiring waivers from participants in activities or purchasing liability insurance. Both of these methods to reduce the risk of liability, however, pose their own difficulties. The waivers, for example, must be informed and third-party liability insurance can be prohibitively expensive.

## VI CONCLUSION

Each group should assess the level of risk given their particular circumstances before deciding whether or not to operate as an unincorporated association or to apply for incorporation. Although it is not possible to assess risk in the abstract, there are some activities that obviously give rise to concerns about the level of risk for potential liability. For example, activities that involve personal safety, such as physical activity or contact sports, or significant contractual obligations would raise legitimate concerns about risk of potential liability for both the officers and directors and the members of an unincorporated association. Similarly, if the organization owns real property, especially if the public is invited to attend, incorporation would be a worthwhile consideration. On the other hand, an organization that only meets socially or to discuss issues of the day arguably does not need to incorporate given the minimal risk involved.

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<sup>56</sup> R.S.O. 1990, c. C.38, ss. 129 and 130.

<sup>57</sup> R.S.O. 1990, c. C.35, ss. 21–24.