Identification and Management of Key Legal Compliance Issues for Associations

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OVERVIEW

- Different Types of Associations
- Different Legal Forms of Associations
- Organization and Legal Documentation
- Utilizing Multiple Corporations
- Board Management Issues
- Reducing Board Liability
- Insurance Considerations
- Third Party Use of Association Property
- Real Property Issues
- Intellectual Property Issues

DIFFERENT TYPES OF ASSOCIATIONS

Charitable Associations

- What is a charity?
  - At common-law a charity includes
    - Relief of poverty
    - Advancement of education
    - Advancement of religion
    - Other purposes beneficial to the community recognized by the courts

Employment And Volunteer Matters

- Charitable And Fundraising Activities
- Fiscal Management Issues
- Investment Issues
- Donor Restricted Trust Funds
- Maintaining Charitable Registration
- National/International Relationships
- Anti-Terrorism Legislation
- Bill C21 (Canada Not-for-Profit Corporations Act)

Note: For more details see attached checklists, articles and newsletters at www.charitylaw.ca and www.antiterrorism.ca
Under the Charities Accounting Act – “charitable purpose” is defined
  - Codifies the common law definition of what is a charity
  - Definition does not extend to broader definition under the Income Tax Act

Under the Income Tax Act – “qualified donees” concept was introduced
  - Includes a “registered charity”
    - Defined as “charitable organization”, “public foundation” and “private foundation”

No definition of a “charity” but reflects the common law
  - Includes extended statutory list of “qualified donees”
    - Registered Canadian amateur athletics associations
    - Low-cost housing co-operatives for the aged
    - Municipalities
    - United Nations
    - Prescribed universities
    - Her Majesty in right of Canada or a province

What are the tax advantages of being a charity?
  - A charity does not pay tax on income or capital gains
  - A charity can issue charitable receipts to donors as tax credits for income tax purposes
  - A gift for income tax purposes can now include consideration back to donor

What are the legal forms available for a charity?
  - Charitable trusts
  - Unincorporated associations
  - Non-share capital corporations
Not-for-profit Associations

- What is a not-for-profit organization under the Income Tax Act?
  - Club, society or association
  - Must not be a charity
  - Organized and operated exclusively for social welfare, civic improvement, pleasure or recreation, or any other purpose, except profit
  - No part of the income can be payable or available to any proprietor, member or shareholder

- What are the tax advantages of being a not-for-profit organization?
  - A not-for-profit organization does not pay tax on income or capital gains except income from property of an organization whose main purpose is to provide dining, recreation or sporting facilities
  - A not-for-profit organization cannot issue charitable receipts for income tax purposes

- What are the legal forms available for not-for-profit organizations?
  - Unincorporated associations
  - Non-share capital corporations
  - Examples would include
    - Recreational clubs
    - Service clubs
    - Trade associations
    - Professional associations
DIFFERENT LEGAL FORMS OF ASSOCIATIONS

- Unincorporated associations (Not-for-profit but not a legal entity)

  - Executive
  - Members

- Share capital corporate associations (can be either for profit or not-for-profit)

  - Employees
  - Officers
  - Directors
  - Shareholders (Owners)

- Non-share capital corporate associations (not-for-profit purpose but not charitable)

  - Employees & Volunteers
  - Officers
  - Directors
  - Members (non-owners but often beneficiaries)
Non-share capital charitable corporate associations
(wholly charitable purpose akin to a public trust)

Employees
& Volunteers

Officers

Directors

Members
(non-members but accountability group
for the public trust)

claims

ORGANIZATION AND LEGAL DOCUMENTATION

• General overview of organizational & legal documentation
  – Identify existence and location of key organizational documents
    • Develop an inventory of key documents
    • Maintain central location for key documents

• Identify key organizational documents for an unincorporated association
  • Constitution and amendments, if applicable
  • Policy statements, if applicable

• Key organizational documents for an incorporated association
  • Letters patent and supplementary letters patent, if applicable
• Membership covenant and mission statement, if applicable
• By-laws and resolutions
• Directors, members and debt registers
• Copies of government filings
• Determining other key legal documents
  • Leases, deeds and mortgages
  • Agency, association and joint venture agreements
  • License agreements

• Business name, trade-marks, Section 9 official mark registrations and domain names
• Charitable registration number
• Policy statements, i.e. sexual abuse and volunteer policy statements
• Insurance policies
• Privacy policy
• Investment policy
• Review of key documents for an unincorporated association
  • Are the objects clearly stated in the constitution and are they not-for-profit?

• Review of key documents for an incorporated association
  • Review of letters patent
    • Is the name in the letters patent the correct name of the association consistent with the objects?

– Do constitutional documents correctly reflect how the organization is actually structured and operated?
– For charitable associations, is a copy of the constitution filed with the appropriate government agencies, i.e. with Canada Revenue Agency (“CRA”) and the Public Guardian and Trustee (“PGT”)?

• Review of key documents for an incorporated association
  • Review of letters patent
    • Is the name in the letters patent the correct name of the association consistent with the objects?
• Are its objects appropriate for a not-for-profit organization, i.e. are they not charitable?
• Are the activities of the association authorized by its corporate objects?
• Is the dissolution clause complementary to the objects or does it provide for distribution to its members?
  – Review of supplementary letters patent
    • Has there been a change of corporate name?
    • Has there been a change of corporate objects?

– Letters patent of amalgamation (only for Ontario corporations):
  • Are the objects the same or similar?
  • What are the terms of the amalgamation agreement?
– Need to review corporate by-law for basic terms, such as
  • Do provisions conflict with letters patent?

• Do provisions reflect changes to corporate legislation?
• Is there an adequate indemnification provision?
• Are the by-law amendment procedures consistent with corporate legislation?
  – Was initial corporate organization of the association properly done?
  – Was there a documented transfer of assets and liabilities on incorporation?
  – Are the records of board decisions and/or membership meetings complete?
– Was there adequate board and/or members’ authorization for indebtedness?
– Have corporate records been properly maintained?
– Have necessary corporate filings and registrations been kept up to date?
  • Ontario Corporations
    – Initial Notice and Notice of Change - Form 1
    – Business Name Act (Ontario) registrations

– Mandatory reporting to Public Guardian and Trustee for charitable associations

  • Canada Corporations
    – Annual Summary (Form 3) - Canada
    – Extra-Provincial Initial Notice (Form 2) - Ontario
    – Business Name Act (Ontario) registrations
    – Mandatory reporting to Public Guardian and Trustee for charitable associations

– Does the association operate and/or fundraise in any other provinces? If so, there may need to be registration as extra-provincial corporation in other provinces, together with business name registrations

  • Does the association need to continue itself under the proposed new Canada Not-for-Profit Corporations Act?
    – Has there been loss of corporate status for failure to maintain government filings?
    – Is the association aware of the importance of proper use of corporate name and operating names?
• Has the association developed and implemented risk management policy statements on:
  – child abuse
  – sexual abuse
  – sexual harassment
  – bullying
  – volunteer conduct
  – safety in the workplace
• Has the association conducted an inventory of its assets?

BILL C-21 (CANADA NOT-FOR-PROFIT CORPORATIONS ACT)

Bill C-21: An act respecting not-for-profit corporations and other corporations without share capital
• First reading: November 15, 2004
• Will replace Canada Corporations Act (CCA)
• Modelled on the Canada Business Corporations Act
• All existing CCA corporations will be required to continue under the new act within 3 years of it coming into force

Highlights of Bill C-21
• Streamlined incorporation “as of right” – incorporation will be granted upon filing required forms and payment
• Incorporation will take a matter of hours instead of weeks
• No filing of by-laws
• More corporate fundamental changes possible amalgamation and continuance
• Efficient process for special act corporations to be continued under new act
• Rights of members better enhanced and protected
• An objective standard of care and a due diligence defence for directors and clarifies directors and officer duties
• Graduated levels of financial review required depending on a corporation’s category and gross annual revenue
• Requirement to provide financial statements to members, directors and officers as well as to the Director under the act

Timing
• Depends on when receives royal assent
• Could be as early as March 2006
• File those annual summaries: Industry Canada is dissolving all federal corporations who are not in good standing in meeting their filing requirements before new act is in force

Standard of Care for Directors:
• Brought in line with business corporation statutes across the country

• Every director and officer of a corporation in exercising their powers and discharging their duties shall
  – Act honestly and in good faith with a view to the best interests of the corporation
  – Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances
• The Bill provides increased protection but more accountability as it provides more instances of director obligations and enhancement of member right
Protection from Liability for Directors

- Provided that directors meet the standard of care, they will be protected from liability.
- Directors and officers are provided a due diligence defence that can be relied on if they are named in an action.
- Directors will satisfy the due diligence defence requirement if they “exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances” including good faith reliance on financial statements of the corporation or a report of a professional person (accountant or lawyer).

Indemnification

- Bill C-21 allows a corporation to indemnify a present or former director or officer or another individual who acted at the corporation’s request and a corporation may advance money to any such person in respect of the costs of a proceeding against them provided that the individual acted honestly and in good faith and with a view to the best interest of the corporation.
- The Bill also broadens and provides considerable detail regarding the scope of situations in which a director or officer would be indemnified for costs and awards arising out of legal actions.

Insurance

- Corporations are specifically authorized to purchase insurance to protect directors and officers from liability.

Right of Dissent

- Statutory right to dissent allows a director to avoid responsibility for actions or resolutions taken during a board meeting by having his or her dissent recorded.
- Similar protection extended even where not present at board meeting (as long as dissent registered within a prescribed time).
Directors not Trustees

- The Bill clarifies that a corporation owns any property of any kind that is transferred to it and does not hold its property in trust unless the property was expressly transferred in trust for a specific purpose.
- It also clarifies that directors are not trustees for any property held in trust by the corporation.

UTILIZING MULTIPLE CORPORATIONS

- Should the association consider using multiple corporations for its high risk activities in order to reduce liability exposure and protect assets?
- Should the association consider establishing a separate foundation to fund exclusively charitable objects that are complementary to the not-for-profit organization?

- Has appropriate consideration been given to balancing control of multiple corporations with issues involving the possibility of cross over liability?
- Has appropriate consideration be given to implementing effective control through contracts and/or licensing agreements as an alternative to overt corporate control?
BOARD MANAGEMENT ISSUES
• Is the association able to identify who is in charge of the association?
  – Where does the de facto control of the association lie? Is it with a board, a committee or executive staff?
  – Is board authority recognized by the membership?
• Are there clearly defined lines of authority between the board and the executive staff?
• Does the board meet on a regular basis and do directors regularly attend?

• Has an audit committee been established to review financial statements and the auditors’ report?
• Is there adequate communication of board responsibilities to existing and future board members?
  – Need to create a board binder of all corporate documents, as well as an explanation of the general operations of the corporation as a charity and the board of directors’ legal duties and liabilities
  – Need to provide regular updates on changes in the law to board members

REDUCING BOARD LIABILITY
• Do any directors receive direct or indirect remuneration that has not been disclosed to the full board of directors?
• Has the association adequately indemnified its directors and officers?
• Has the board authorized the association to acquire directors’ and officers’ liability insurance?
Has the board delegated too much responsibility to executive staff by restricting itself to policy decisions only without careful and ongoing monitoring and review?

Should the association consider reducing the size of the board to limit the number of people who are exposed to liability as directors?

Is the association effectively making use of committees as an alternative to a large board of directors?

Do the board members on occasion need to receive independent legal advice due to liability exposure?

Should the association consider implementing an advisory board to complement the board of directors without a corresponding exposure to liability?

Has the association established a comprehensive due diligence review process by establishing and utilizing a legal risk management checklist?

Has a risk management committee of the board been established?

INSURANCE CONSIDERATIONS

Has the association maintained a historical record of its insurance coverage in the event of a future claim?

Is there occurrence-based or claims-made insurance coverage for sexual abuse?

Has the association provided full written disclosure of all risks to its insurer to avoid denial of coverage?

Does the association require regular reports from its insurance broker on existing coverage, exclusions from coverage and recommendations to enhance coverage?
Is there a regular review of the adequacy and extent of general liability coverage and property insurance?

Is there a regular review of directors’ and officers’ liability coverage?

Does there need to be special insurance endorsements to extend insurance coverage, e.g. activities of agents in foreign countries?

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THIRD PARTY USE OF ASSOCIATION PROPERTY

Is the association aware of potential liability exposure in permitting third parties to use its property?

Has the association developed and implemented a third party property use agreement with appropriate releases and indemnification?

Does the association require evidence of liability insurance from third party users of its facilities?

Does the association charge appropriate fair market rental fees to these properties?

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REAL PROPERTY ISSUES

Has an environmental assessment been conducted to determine the extent of liability exposure for associations?

Are there trust provisions in old title documents that may impact real property held by a charitable association?

Has the not-for-profit organization addressed and rectified encroachments with neighbouring lands?

Are municipal zoning and legal non-conforming uses being complied with?
Could a charitable association be forced to sell surplus land or risk vesting in the Public Guardian and Trustee after three years under Charities Accounting Act (Ontario)?

Has the not-for-profit reviewed its municipal property tax to determine both classification and valuation?

INTELLECTUAL PROPERTY ISSUES

- Does the association need to register any of its key names and/or logos as trade-marks?
  - Identify trade-marks
  - Protect trade-marks by registration
  - Use trade-marks in conjunction with appropriate marks
  - Ensure that any third parties using trade-marks enter into a trade-mark licensing agreement
  - Has the association protected its trade-mark by securing multiple corresponding domain names?
- Who owns the copyright for publications of the association?
- Should copyright be registered, assigned or licensed?

EMPLOYMENT AND VOLUNTEER MATTERS

- Has the association developed appropriate hiring policies and practices for its employees?
- Is there compliance with applicable human rights legislation?
- Is there need for an employment contract with key employees?
- Is there a need to develop and adopt statements and/or manuals for employees as well as volunteers?
- Do employees and volunteers who deal with children need to be screened and supervised in accordance with an appropriate sexual abuse policy statement?
• Is there need for a discipline procedure for employees and/or volunteer members?

• Is the association aware of and complying with applicable statutory requirements, such as pay equity, employment standards, human rights legislation, privacy legislation and occupational health and safety prerequisites?

• Is the association and the board exposed to criminal liability under the *Criminal Code* i.e. Bill C-45 (Westray Mines)?

CHARITABLE AND FUNDRAISING ACTIVITIES

• Has the charitable association ensured that charitable activities are done in accordance with its charitable objects?

• Are fundraising and/or administrative costs kept within the 80/20 disbursement quota?

• Has fundraising legislation, where applicable, been complied with?

• Have fundraising programmes been reviewed by legal counsel?

• Are donors’ rights to require accountability respected, particularly rights under the *Charities Accounting Act* (Ontario)?

• Does the charitable association have a privacy policy in place in order to protect donor’s rights?

• Are sponsorship arrangements properly documented?
FISCAL MANAGEMENT ISSUES
• Are all salaries and benefits being paid by the association?
• Is the association operating with a deficit and, if so, for how long?
• How is the deficit being funded?
• Has a sinking fund been established to retire debt?
• Are investments being offered to the public without full disclosure to potential investors?

INVESTMENT ISSUES
• What investment powers apply to investment of surplus funds of the association?
  – Investment power may be found in the letters patent or supplementary letter patent
  – Investment power may be found in incorporation legislation
  – Investment power may be found in the Trustee Act (Ontario), particularly for a charitable association
• Does the association need and/or have an investment policy?
  – Documenting compliance with prudent investor rule
  – Establishing requirements for delegation of investment decision making, particularly for a charitable association

DONOR RESTRICTED TRUST FUNDS
• Are there donor restricted trust funds being held by the charitable association?
  – Building funds
  – Endowment funds
  – Special project funds
  – Ten year gifts
• Are restricted funds used only in accordance with applicable restrictions?

• Are restricted funds being used in whole or in part for general operational purposes or are they being borrowed against?
• Are restricted funds segregated from operating funds?
• Is there compliance under the Charities Accounting Act (Ontario) to co-mingle restricted funds for investment purposes?
• Is the board of the charitable association aware of the consequences of breach of trust for failing to comply with restricted funds?
MAINTAINING CHARITABLE REGISTRATION

- Is the legal name of the charity and/or its operating name consistent with the records of CRA?
- Does CRA have the current head office address of the charity?
- Has the charity obtained Quebec charitable status for fundraising in Quebec?
- Does the charity submit its annual charity information return (form T3010) on a timely basis?
- Has the charity complied with its disbursement quota?
- Can the association comply with the new disbursement quota rules of December 2004?
- Is the charity involved in political activities within CRA limits?

- Is the charity involved in related business activities within CRA guidelines?
- Is the charity aware of the applicable rules on the issuance of charitable receipts and split receipting and anti-tax shelter provisions?
- Are agency and/or joint venture relationships with non-qualified donees properly documented?
- Is the charity involved in fundraising through tax shelters?
- Does the board of directors review the annual return (T3010A) for the charity before it is filed each year?
- Is the charity prepared for a spot audit by CRA?

NATIONAL/INTERNATIONAL RELATIONSHIPS

- Multi-tiered provincial or national charities
  - Single corporate structure provides ease of administration, but results in greater risk of liability exposure for total assets of single corporate entity
  - Multiple corporate structure reduces risk of liability, but top tier organization may still be exposed to liability where too much control is imposed or employer/employee relationship exists
  - The reverse is also a risk: top-tier corporations can lose control over subsidiaries without proper corporate control in place and appropriate agreements
• Are relationships with national organizations and/or subsidiary chapters adequately documented?

• Are relationships between national and international structures adequately documented with specific reference to controlling trademark?

• Has the ownership of trade-marks and/or copyrights been determined?

• Have trade-marks and copyrights been adequately protected and licensed?

ANTITERRORISM LEGISLATION

• Does association carry on operations that may require it to be in compliance with anti-terrorism legislation?
  – International operations
  – Domestic operations

• Has the charity undertaken appropriate due diligence procedures in complying with anti-terrorism legislation?
  – Development of an anti-terrorism policy statement.
  – Development of resource materials on anti-terrorism legislation
  – Requiring disclosure statements for board members and staff
  – Evaluating all charitable programs for compliance
  – Requiring disclosure statements from affiliated charities, third party agents and/or partners and conducting appropriate inquiries
  – Determining when to make inquiries of donors
  – Conducting due diligence internet searches on directors, officers and agents
• Are directors aware of risks associated with failing to comply with anti-terrorism legislation?
  – Loss of charitable status
  – Personal liability in civil law
  – Possible criminal law sanction