THE HAMILTON LAW ASSOCIATION
Continuing Legal Education Committee

“Charity Law”

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Advising the Charitable Client

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent
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tcarter@carters.ca
1-877-942-0001
A. OVERVIEW

- The Significance of Charities and Charity Law
- The Fundamentals of a Charity
- The Fundamentals of a Not-for-Profit Organization
- The Challenge in Advising the Charitable Client
- Minimizing the Lawyer’s Exposure to Risk
- Strategies to Address Those Risks
- Developing a Legal Risk Management Checklist

Note: For more details see articles and newsletters at www.charitylaw.ca

B. THE SIGNIFICANCE OF CHARITIES AND CHARITY LAW

- In the twelve-month period covered, 84% of the population made a financial donation to a charitable or non-profit organization
- In 2007, charitable giving increased from previous years to $10 billion
- Most lawyers advise charities on an infrequent basis and often do so for reduced fees or on a *pro bono* basis
Advising charities, however, is now a very complicated area of the law and is becoming more so all the time. Charities are facing fundamental changes and challenges, particularly in a more litigious society. Charities need to rely on legal advice more than they have in the past. Lawyers must provide professional and competent advice no matter what the fee charged is. Lawyers need to have a more active mind-set in identifying problems and providing legal advice to charitable clients. Legal advice needs to change from benign passivity to proactive legal risk management.

C. THE FUNDAMENTALS OF A CHARITY

What is a charity?
- At common-law (the Pemsel Test) includes
  - Relief of poverty
  - Advancement of education
  - Advancement of religion
  - Other purposes beneficial to the community as recognized by the courts
- Under the Charities Accounting Act – “charitable purpose” is defined
  - It codifies the common law definition of what is a charity
  - Definition does not extend to broader definition under the Income Tax Act (“ITA”)
- Under the ITA – “qualified donee” concept 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
  - Charitable organizations outside Canada to which the government has made a gift in the last 12 months
  - 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 to donor (“split-receipting”)

What are the legal forms available for a charity?
- Unincorporated associations
- Charitable trusts
- Non-share capital corporations

D. THE FUNDAMENTALS OF A NOT-FOR-PROFIT ORGANIZATION
- Under the ITA a not-for-profit is defined as a non-profit organization
- What is a non-profit organization under the ITA?
  - 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
• CRA has indicated that, “profit should generally be unanticipated and incidental to the purpose or purposes of the organization”

• CRA has cautioned that retaining excess funds beyond immediate operating costs may be evidence that an organization is operating with a profit purpose, but, “this will not in and of itself result in the organization failing to qualify as a 149(1)(l) entity”

• Therefore, non-profits must carefully justify any excess surplus as this could put them in danger of losing non-profit status

• What are the tax advantages of being a non-profit organization?
  – A non-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 non-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

• It is up to CRA to determine whether or not a non-share capital corporation or an unincorporated association qualifies as a nonprofit organization under subsection 149(1)(l) of the ITA

• Examples would include
  – Recreational clubs
  – Service clubs
  – Trade associations
  – Professional associations
E. THE CHOICE OF ORGANIZATIONAL STRUCTURE

- Charities and Not-for-Profits as Unincorporated Associations
  - Not a legal entity
  - Generally used for starting up a charity or not-for-profit in its early stages
  - Flow through liability to members

- Charities as Charitable Trusts
  - A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property
  - Available for charitable organizations, public foundations and private foundations
  - Trustees are exposed to liability

- Charities and Not-for-Profits as Corporations
  - Separate legal entities
  - Members are not exposed to liability
  - Directors may be still exposed to personal liability from fiduciary and management responsibilities

F. THE CHALLENGE IN ADVISING THE CHARITABLE CLIENT

- The nature of the charitable client
  - Motivated by a sense of the greater good
  - Inherent lack of continuity, i.e. frequent change in directors and executive staff
  - Varied extent of commitment by volunteers
  - Frequently internal differences of opinion in how to structure and operate the charity
  - Generally feel thwarted by legal process and the need to comply with the law

- General lack of understanding of legal requirements by directors and executive staff
  - Generally focus on programs and fundraising over compliance with legal requirements
  - Generally a lack of understanding of the exposure of directors and officers to personal liability
- Frequently there is an unrealistic expectation of the lawyer by the charitable client
  - Lawyers may be expected to provide complicated legal services *pro bono* or at significantly reduced rates

- Reduced fees or *pro bono* service does not justify incomplete legal advice
  - Lawyer’s involvement in even small matters is often seen as the legal seal of approval on everything that a charity does
  - Lawyers may be susceptible to accountability in not having warned the client of potential risks
- Why the charitable client often experiences difficulties
  - The need to comply with complicated statutory requirements both federally and provincially

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Increased exposure of directors and officers to liability arising from a more litigious environment

Complicated tax issues, particularly with recent technical changes to the ITA

Fundraising requirements both federally and provincially

Complicated management of gifts and compliance with receipting requirements

Inherent risks in operations, such as sexual abuse of children

Compliance with requirements under anti-terrorism legislation

Determining appropriate investment policies involving charitable funds

Complicated organizational structures

Interrelationships between multiple corporations

Employment issues involving full and part time staff

Privacy issues

Lack of adequate contractual documents

Consequences of legal deficiencies in charitable structure and operations

Legal actions by donors and/or the Public Guardian and Trustee

Allegations of breach of trust

Revocation of charitable status

Confusion in corporate operations

Loss of corporate status

Undertaking ultra vires activities

Court supervised audit of accounts

Inquiries under Charities Accounting Act
• How the lawyer can encounter difficulties in advising the charitable client
  – Charities often do not know what questions to ask, let alone the answers
  – Lawyers must fully explain the legal process to the charitable client
  – Lawyer must warn the charity of applicable risks
  – Lawyer must advise if there are better alternatives available
  – Lawyer must advise charitable client on related risks notwithstanding limited nature of retainer

• Conflicts of interest for lawyers in advising the charitable client
  – If a lawyer is a member of the board of a charity, the lawyer cannot receive fees
  – Lawyers who are members of a board may face conflict if called upon to provide legal advice to the charity
  – Acting as solicitor for two related charities
  – Lawyer acting for a charity cannot advise directors of that charity personally
  – May need to communicate with board members directly where executive director is blocking communication from the lawyer

G. MINIMIZING THE LAWYER’S EXPOSURE TO RISK
• Need to develop a preventative proactive response
• Lawyer must be more than a legal technician
• Must change from giving passive advice that is reactive only to proactive advice given in a preventative context
• Need to identify and avoid legal problems before they occur
H. STRATEGIES TO ADDRESS THOSE RISKS
• Lawyer must be familiar with many aspects of the law in order to advise charitable clients of all applicable legal issues
  – Federal and Provincial Tax Issues
  – Corporate matters
  – Trust issues
  – Contracts
  – Risk management
  – International relationships
  – Intellectual Property

• Lawyers also need to be familiar with change in the law. For example in the past year there have been significant changes:
  – i.e. Canada Not-for-Profit Corporations Act
  – i.e. Ontario Not-for-Profit Corporations Act
  – March 2010 Federal Budget and DQ Reform
  – Ontario Bill 212
• Lawyer should assume that the charitable client knows little about charity law

• Lawyer must be diligent in asking questions of the charitable client
• Lawyer needs to explain the relevant law to the client in order to avoid problems in the future
• Lawyer needs to fully explain consequences of intended course of action and alternatives
• Lawyer needs to provide recommendations to rectify the problems identified
• Lawyer needs to provide a prioritization of action items to be undertaken, in an organized report to the client even if it is only in point form
• The onus to respond or take action should be clearly placed on the client
• Lawyer needs to provide explanation of steps that need to be taken and time frame to do so
• Lawyer should try to follow up with client, particularly where there is a change of staff or board members

I. DEVELOPING A LEGAL RISK MANAGEMENT CHECKLIST
• Checklist helps to keep track of a multitude of legal issues
• Assists clients in understanding the interrelationship between legal issues
• Helps to identify and focus on problem areas to be addressed

• See attached Risk Management Checklist as a sample
• How to utilize a checklist
  – Provide a copy of a checklist to the client and retain a file copy
  – Keep notes on the checklist
  – Provide a report and review of the checklist
  – Hold subsequent meeting with client to follow up on the checklist
J. EFFECTIVELY COMMUNICATING WITH THE CHARITABLE CLIENT

• Written report to charitable client is essential
  – The collective memory of a charitable client can quickly lapse because a charity is an institution with changing stakeholders
  – e.g. frequent change of executive staff and/or directors
  – e.g. poor record keeping by the charity
• Confirm retainer with charitable client
  – What the lawyer is doing for the client
  – What the lawyer is not doing for the client

• Report to client should be of an educational nature
  – Explain issues to be addressed
  – Explain law and application to facts
• Document advice given to charitable client
  – Identify who the advice is being given to
  – Confirm any verbal advice given
  – Set out steps to remedy problems
  – Explain areas of uncertainties

• Provide proactive action plan for the charitable client
  – Prioritize legal issues to be addressed by the charity
  – Set out realistic time line for work to be done
  – Explain the nature of the legal work that is required
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