
HALTON LAW SERIES

HALTON REGION & COMMUNITY PARTNERS PRESENT...

“Leadership Matters: Building Your Legal Know How”

Oakville – September 16, 2010

Key Legal Compliance Issues for Charities and Not-for-Profits

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent

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A. OVERVIEW OF PRESENTATION

- The Need for Due Diligence in Addressing Compliance Issues
- Identifying the Differences Between Charities and Not-for-Profit Organizations
- Identifying the Different Types of Legal Forms for Organizations
- Key Organizational and Legal Documentation
- Utilizing Multiple Corporations
- Board Management Issues
- Reducing Board Liability
- Insurance Considerations
- Third Party Use of Property

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- Real Property Issues
- Intellectual Property Issues
- Employment and Volunteer Issues
- Investment Issues
- Fiscal Management Issues
- Donor Restricted Trust Funds
- Maintaining Charitable Registration
- Maintaining Non-profit Status

Note: For more details see Checklists, Articles and Newsletters at www.charitylaw.ca, www.churchlaw.ca and www.antiterrorismlaw.ca

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B. THE NEED FOR DUE DILIGENCE IN ADDRESSING COMPLIANCE ISSUES

- Charities and not-for-profit organizations collectively make up an essential part of Canadian society and its economy
- Charities and not-for-profits constitute the third sector of the economic engine of Canada i.e. not including universities or hospitals, the sector employs 7.2% of the Canada's workforce
- Charities and not-for-profits are facing fundamental changes and challenges in delivering their services to the public, in part because of a more litigious society

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- In facing these challenges, charities and not-for-profits must become familiar with a vast array of legal requirements ranging from corporate law, trust law, to tax and international structures and agreements
- In order for charities and not-for-profits to comply and avoid exposure to legal liability, it is essential that they exercise due diligence in addressing legal compliance issues
- Why do charities and not-for-profits often experience difficulties in complying with legal requirements?

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- Complicated corporate and charitable requirements at both the federal and provincial level
- Increasingly complicated tax issues
- Increased fundraising demands
- Due diligence required in charitable receipting
- Inherent risks in operations, such as sexual abuse of children
- Determining appropriate investment policies
- Incomplete corporate records

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- Privacy issues involving donors, employees and volunteers
- Frequently inadequate contractual documents
- Possible consequences from deficiencies in compliance issues include:
 - Revocation of charitable status
 - Loss of corporate status
 - Unauthorized activities
 - Confusion in corporate operations
 - Allegations of breach of trust

- Inquiries by the public under the *Charities Accounting Act* (Ontario) for charities
- Legal actions by donors and/or the Public Guardian and Trustee (“PGT”) for charities
- Due diligence in addressing compliance issues involves the charity or the not-for-profit organization asking the following basic questions:
 - What is the legal nature of the organization?
 - What are its legal obligations?
 - How can the organization effectively comply with those legal obligations?

- Due diligence must be undertaken in a pro-active manner in order to anticipate and avoid legal problems before they occur
- The due diligence required needs to change from a passive to a pro-active approach in addressing compliance matters
- What follows is a series of key considerations and issues that charities and not-for-profits should address in order to identify and comply with key compliance issues

C. IDENTIFYING THE DIFFERENCES BETWEEN CHARITIES AND NOT-FOR-PROFIT ORGANIZATIONS

Charities - Key Concepts

- **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**

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- **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 CRA uses the definition at common law**
 - **Includes extended statutory list of “qualified donees”**
 - **Registered Canadian amateur athletics associations**

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- **Low-cost housing co-operatives for the aged**
- **Municipalities**
- **United Nations and its agents**
- **Prescribed universities**
- **Charitable organizations outside Canada to which the federal government or its agents has made a gift during the taxpayer’s taxation year or the 12 months before it**
- **Her Majesty in right of Canada or a province**

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- 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 individuals) deductions (for corporations) for income tax purposes
 - A gift for income tax purposes now permit consideration to be received back by the donor (split-receipting)
- What are the legal forms available for a charity?
 - Unincorporated associations
 - Charitable trusts
 - Non-share capital corporations

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- Not-for-profit Organizations – Key Concepts**
- What is a not-for-profit under the *Income Tax Act* (technically a “non-profit organization”)?
 - Club, society or association
 - In the opinion of the Ministry was not 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 for the personal benefit of any proprietor, member or shareholder

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- What are the tax advantages of being a not-for-profit under the *Income Tax Act* (technically a “non-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
 - However, a not-for-profit organization cannot issue charitable receipts for income tax purposes

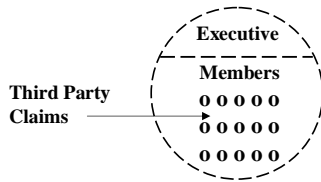
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- What are the legal forms available for not-for-profit organizations?
 - Unincorporated associations
 - Non-share capital corporations
- Examples would include
 - Recreational clubs
 - Service clubs
 - Trade associations
 - Professional associations

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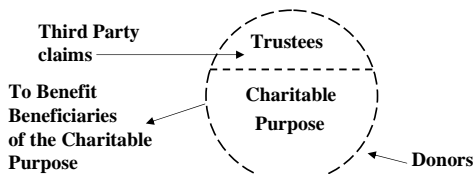
D. IDENTIFYING THE DIFFERENT TYPES OF LEGAL FORMS FOR ORGANIZATIONS

- 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



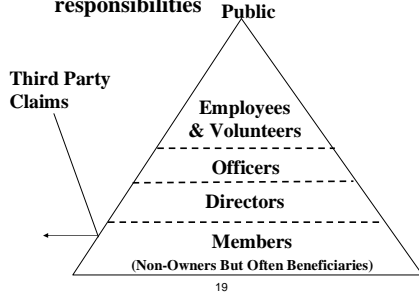
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- Charities as Charitable Trusts
 - A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property
 - Available for charitable organizations, public foundations and private foundations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



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- **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**



E. KEY ORGANIZATIONAL AND LEGAL DOCUMENTATION

- **General overview of key organizational & legal documentation**
 - **Identify the existence and the location of key organizational and legal 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**
 - **Policies and procedures, if applicable**
- **Identify key organizational documents for an incorporated organization**
 - **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
- Identify other key legal documents
 - Leases, deeds and mortgages
 - Agency, partnership and joint venture agreements, contracts for service
 - License agreements

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- Business name, trade-marks, official marks and domain names
- Charitable registration number, T3010's and correspondence from CRA
- Policy statements, i.e. sexual abuse and volunteer policy statements
- Historical record of insurance policies
- Privacy policies
- Investment policies
- Content review of key documents for an unincorporated association
 - Are the objects clearly stated in the constitution and are they charitable or not-for-profit in nature?

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- Do constitutional documents correctly reflect how the organization is actually structured and operated?
- For charities, 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")?
- Content review of key documents for an incorporated organization
 - Review of letters patent
 - Is the name in the letters patent the correct name of the organization and is it consistent with its objects?

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- Are its objects appropriate for a not-for-profit organization, i.e. are they not charitable, or for a charity, are they exclusively charitable in nature?
- Are the activities of the organization authorized by its corporate objects?
- For a not-for-profit organization, is the dissolution clause complementary to the objects or does it provide for distribution to its members?
- For a charity, does the dissolution clause provide for distribution to other charities

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- Review of supplementary letters patent (SLP)
 - Have all SLPs been identified
 - Has there been a change of corporate name?
 - Has there been a change of corporate objects?
- Does the organization have historical records of all of its by-laws?
- Need to review the current corporate by-law for basic terms, such as
 - Do provisions conflict with letters patent concerning objects or dissolution?
 - Do the provisions reflect the actual organization and operational structure of the organization?

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- Does the by-law reflect recent changes to applicable corporate legislation?
- Is there an adequate indemnification provision for the directors?
- Are the by-law amendment procedures consistent with corporate legislation?
- Was initial organization of the corporation properly done?
- Was there a documented transfer of assets and liabilities on incorporation?
- Are the records of board decisions and/or membership meetings complete?

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- Is there adequate board and/or members' authorization for contract as indebtedness?
- Have corporate records been properly maintained, such as consent to be a director or applications for membership?
- Where are the corporate records kept?
- 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

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- Mandatory reporting to Public Guardian and Trustee for charitable organizations
- Federal 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 organizations

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- Does the organization operate and/or fundraise in any other provinces? If so, there may need to be registration as extra-provincial corporations in other provinces, together with business name registrations
- Does the organization need to continue itself under either the new Canada *Not-for-Profit Corporations Act* or the new Ontario *Not-for-Profit Corporations Act*?
- Has there been loss of corporate status for failure to maintain government filings?
- Is the organization aware of the importance of proper use of corporate name and operating names?

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- **Has the organization developed and implemented appropriate risk management policy statements concerning:**
 - **child protection**
 - **sexual harassment and workplace violence**
 - **bullying**
 - **volunteer recruitment**
 - **safety in the workplace**
 - **protocol for foreign volunteer projects**
- **Has the organization conducted an up to date inventory of its assets?**

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F. UTILIZING MULTIPLE CORPORATIONS

- **Should the organization consider using multiple corporations for its high risk activities in order to reduce liability exposure and protect assets?**
- **Different types of multiple corporations that can be implemented**
 - **Parallel operating organizations**
 - **Parallel charitable foundations**
 - **Umbrella organizations**

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- **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?**

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G. BOARD MANAGEMENT ISSUES

- **Is the organization able to identify who is in charge of the organization?**
 - Where does the de facto control of the organization 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?**

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- **Has the board delegated too much responsibility to executive staff by restricting itself to policy development only without a careful and ongoing monitoring and review of policy implementation?**
- **Has an audit committee been established by the board to review financial statements and the auditors' report?**
- **Has the board established a comprehensive due diligence review process by establishing and utilizing a legal risk management checklist?**

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- **Has a risk management committee of the board been established?**
- **Is there adequate communication of board responsibilities to existing and new board members?**
 - Need to create a board binder of all organizational documents and inventory of assets, as well as an explanation of the general operations of the organization and the board of directors' legal duties and liabilities
 - Need to provide regular updates on changes in the law to board members

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H. REDUCING BOARD LIABILITY

- Do any directors of a charity receive direct or indirect remuneration? If yes, all board members may be jointly and severally liable for such remuneration
- Has the organization adequately indemnified its directors and officers, and for a charitable organization has the indemnification been authorized in accordance with the *Charities Accounting Act*?
- Has the board of a charity authorized the organization to acquire directors' and officers' liability insurance in accordance with the *Charities Accounting Act*?

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- Should the organization consider reducing the size of the board to limit the number of people who are exposed to liability as directors?
- Is the organization effectively making use of committees as an alternative to a large board of directors?
- Should the organization consider implementing an advisory board to complement the board of directors without creating a corresponding exposure to liability?

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I. INSURANCE CONSIDERATIONS

- Has the organization maintained a historical record of its insurance coverage in the event of a future claim?
- Has the organization provided full written disclosure on a regular basis of all risks to its insurer to avoid denial of coverage?
- Does the organization request regular written reports from its insurance broker on existing coverage, exclusions from coverage and recommendations to enhance coverage?
- Does the organization know whether it has occurrence-based or claims-made insurance coverage for sexual abuse?

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- Is there a regular board review of the adequacy and extent of comprehensive 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 in "out of the ordinary" situations, e.g. activities of volunteers and agents in foreign countries or non-owned automobiles?

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J. THIRD PARTY USE OF PROPERTY

- Is the organization aware of potential liability exposure in permitting third parties to use its property?
- Has the organization developed and implemented a third party facility use agreement with appropriate releases and indemnification?
- Does the organization require evidence of liability insurance from third party users of its facilities?
- Has the organization provided written notice to its own insurers concerning the use of its property by third parties

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- Does the organization charge appropriate fair market rental fees to users of their properties?
 - Charitable property requires fair market value for rent charged to non-charities
 - Non-charitable properties have more flexibility in the amount of rent that it can charge
- For organizations that are charities, does the third party use constitute an unrelated business prohibited by the *Income Tax Act*?
- For religious charities requiring codes of conduct, has consideration been given to compliance with the *Ontario Human Rights Code*?

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K. REAL PROPERTY ISSUES

Deeded land

- **Has an environmental assessment been conducted to determine the extent of liability exposure for the organization for future acquisitions as well as existing property?**
- **If the organization has fuel oil tanks, either above or below ground, has there been compliance with mandatory provincial fuel oil tank regulations?**
- **Are there trust provisions in old title documents that may impact real property held by a charitable organization that may need to be varied by a court?**

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- **Has the organization addressed and rectified encroachments with neighbouring lands?**
- **Are municipal zoning and legal non-conforming uses being complied with?**
- **Is the charity aware of the 2009 repeal of the three year limitation in renting surplus land under *Charities Accounting Act*?**
- **Has the organization reviewed its municipal property tax assessment to determine both its classification and valuation and if so is there need for reconsideration or appeal of assessment?**

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Leased Land

- **Need to avoid personal guarantees on lease documents where possible**
- **Avoid clauses requiring restoration of leased premises at the end of the lease**
- **Ensure access to adequate parking**
- **Need to limit the extent of tenant expenses under a net lease arrangement**
- **Ensure the right to sub-let and assign the lease, with a release, if possible**
- **Need to address issues of environmental liability for both the landlord and the tenant**

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- Need to carefully monitor the date by which an option to renew the lease needs to be exercised
- The amount of rent on renewal should be made subject to arbitration
- Obtain a covenant from the landlord to prohibit offensive uses of adjoining leased premises
- Does the lease need to be registered on title?
- Obtain a right of first refusal to lease adjoining leased premises

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- L. INTELLECTUAL PROPERTY ISSUES**
- Intellectual property is an essential asset of an organization and consists of both trade-marks and copyright
 - Trade-marks need to be identified, licensed and enforced
 - Trade-marks can be lost if they are not properly protected
 - An organization needs to be pro-active in protecting its trade-marks or risk losing its trade-mark rights by default
 - Registration of a corporate name or business name does not by itself give trade-mark protection

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- Trade-mark rights exist at common law but those rights are limited and should be protected by trade-mark registration under the *Trade-marks Act*
- It is essential that a trade-mark be properly marked with either a TM for an unregistered trade-mark or a ® for a registered trade-mark
- It is essential to properly use and license trade-marks, otherwise the trade-mark can be lost
- An infringement of a trade-mark by others, even if done unintentionally, must be immediately challenged

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- In addition to obtaining a trade-mark registration, an organization should secure multiple domain names as soon as possible using its trade-mark as part of the domain name
- Has the designer of the organization’s website assigned the copyright for the website design?
- Who owns the copyright for publications of the organization and is it properly identified with a notice of copyright protection, i.e. ©?
- Should the copyright material of the organization be registered, assigned or licensed?

- M. EMPLOYMENT AND VOLUNTEER ISSUES**
- Does the organization utilize employment agreements?
 - Has the organization developed appropriate policies and practices for hiring, disciplining and terminating employees and volunteers?
 - Is there a need to develop and adopt a policy statement for employees and volunteers in relation to conduct and performance expectations?
 - Is the organization aware of and complying with applicable statutory requirements, such as pay equity, employment standards, human rights legislation, privacy legislation and occupational health and safety requirements?

- Does the organization have a policy concerning sexual harassment?
- Does the organization (with more than 5 employees) have a workplace violence and harassment policy in accordance with the recent Bill 168?
- Do employees and volunteers who deal with children need to be screened and supervised in accordance with an appropriate sexual abuse policy statement?
- Is the organization aware of and addressing ownership issues regarding intellectual property created by the employees and volunteers?

N. INVESTMENT ISSUES

- **What investment powers apply to investment of surplus funds of the organization?**
 - Investment power may be found in the letters patent or supplementary letter patent
 - Investment power may be found in incorporating legislation
 - Investment power may be found in the *Trustee Act* (Ontario), particularly for a charity or for charitable funds in general

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- **Does the organization need and/or have an investment policy?**
 - To document compliance with prudent investor rule and protection from liability
 - To establish requirements for delegation of investment decision making, particularly for a charitable organization
- **Is the organization aware of the 2009 repeal of the *Charitable Gifts Act* (Ontario) that had limited charities to no more than a 10% interest in a business?**

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O. FISCAL MANAGEMENT ISSUES

- **Are all salaries and benefits being paid by the organization?**
- **Is the organization operating with a deficit and, if so, for how long?**
- **How is the deficit being funded?**
- **Has a sinking fund been established to retire the debt?**
- **Are investments being offered to the public without full disclosure to potential investors?**
- **Are charitable funds being used to fund unrelated business operations of the charitable organization?**

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P. DONOR RESTRICTED TRUST FUND

- Are there donor restricted trust funds being held by the charity?
 - Building funds
 - Endowment funds
 - Special project funds
 - Ten year gifts established prior to the repeal of the 80% DQ in the 2010 Federal Budget
- Are restricted funds used only in accordance with applicable restrictions?

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- Are restricted funds being used in whole or in part for general operational purposes or are they being borrowed against? In either event there would be a breach of trust
- 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 organization aware of the consequences of breach of trust for failing to comply with restricted funds?

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Q. 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 as well as current constating documents?
- Has the charity obtained Quebec charitable status for fundraising in Quebec?
- Does the charity submit its annual charity information return (form T3010B) on a timely basis, i.e. within 6 months of the year end of the charity?

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- Does the charity have its full board of directors review and approve its T3010B before it is submitted each year?
- Is the charity aware of the 2010 repeal of the 80% disbursement quota along with the retention of the 3.5% disbursement quota?
- Is the charity aware of the new Fundraising Guidance from CRA and the need to keep fundraising expenses each year to no more than 35% of fundraising revenue?
- Does the charity provide “accessible and accurate” disclosure of its fundraising expenses to the public?

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- Is the charity aware of CRA’s new Guidance on Charities Operating Outside of Canada?
 - The need for its “own activities” test
 - Need for direction and control of charitable expenditures
 - Need to document arrangements with third parties through written agreements
- Is the charity involved in political activities and if so are they operating within limits permitted by CRA?
- Is the charity involved in business activities and if so, are they operating within the related business guideline permitted by CRA?
- Is the charity prepared for a spot audit by CRA in relation to its books and records?

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R. MAINTAINING NON-PROFIT STATUS

- Does the organization continue to meet the definition of a non-profit organization under the *Income Tax Act*?
- Does the organization carry on for-profit business activities within its operations?
- Does the organization maintain reserves in excess of a reasonable operational reserve?
- If the organization is a corporation, does it file a T2 Return?
- If the organization has income greater than \$10,000 or assets exceeding \$200,000, has it filed a T1044 NPO Return?

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