CBA/OBA
2012 National Charity Law Symposium

Toronto – May 4, 2012

New Ineligibility Requirements for Directors, Officers and Staff of Registered Charities

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New Ineligibility Requirements for Directors, Officers and Staff of Registered Charities

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A. INTRODUCTION

- The 2011 Federal Budget contained significant changes
  - A new regulatory regime for qualified donees
  - Clarification on returning charitable gifts returned to donors
  - Changes to the rules around gifting non-qualifying securities, options to acquire property and flow-thru shares
  - The examination of charitable donation incentives
  - New eligibility requirements for directors and senior staff of registered charities and registered Canadian amateur athletic associations ("RCAAAs")

- The 2011 Federal Budget ("Budget") was initially introduced on March 22, 2011 and was reintroduced on June 6, 2011 in almost identical form
- Bill C-13 was introduced Oct. 4, 2011 and received Royal Assent on Dec. 15, 2011 – most provisions came into force January 1, 2012
- For more information on the Budget generally see Charity Law Bulletin #245 at http://www.carters.ca/pub/bulletin/charity/2011/chylb245.pdf and Charity Law Bulletin #253 at http://www.carters.ca/pub/bulletin/charity/2011/chylb253.pdf
- For more information on "Ineligible Individuals" see Charity Law Bulletin #269 at http://www.carters.ca/pub/bulletin/charity/2011/chylb269.pdf

4

- According to the Budget documents, the "ineligible individual" provisions resulted from CRA concerns that it lacked authority to refuse charitable status, even if applicants were previously involved with charities that had their status revoked for serious non-compliance or had criminal records for offences relating to a breach of public trust, like fraud or misappropriation
- The provisions are meant to provide CRA with the authority to withhold or remove charitable status where such potential risk factors for abuse are present

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5

B. OVERVIEW OF PROVISIONS

- In summary, these provisions give CRA the discretion to refuse or revoke the registration of a charity or RCAAA, or to suspend its receipting privileges, if
  - a member of the board of directors,
  - a trustee,
  - officer or like official, or
  - any individual who otherwise controls or manages the charity or RCAAA

  is an "ineligible individual"

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6

- An "ineligible individual" is a person who:
  - Has been convicted of a criminal offence in Canada or similar offence outside of Canada, relating to financial dishonesty (including tax evasion, theft or fraud) or any other criminal offence that is relevant to the operation of the organization, for which he or she has not received a pardon ("relevant criminal offence")

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7

- Has been convicted of an offence in Canada within the past five years (other than a "relevant criminal offence"), or similar offence committed outside Canada within the past five years that relates to financial dishonesty or any other offence that is relevant to the operation of the charity or RCAAA ("relevant offence")
  - Such offences include offences under charitable fundraising legislation, consumer protection legislation or securities legislation

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- Has been a director, a trustee, officer or like official of, or an individual who otherwise controlled or managed, the operation of a charity or RCAAA during a period in which the organization engaged in serious non-compliance and for which its registration has been revoked within the past five years
- Has been at any time a promoter of a tax shelter that involved a registered charity or RCAAA, the registration of which was revoked within the past five years for reasons that included or were related to its participation in the tax shelter

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9

EXAMPLE

- Charity X has a 25 member board of directors. One of these directors, Carter, was employed as the manager of another charity, Charity Y, in 2002-2003
- Charity Y is audited in 2005 in respect of the 2002 and 2003 taxation years
- In February 2007, Charity Y loses its status for substantial non-compliance, as a result of the imprudent actions of Charity Y's board of directors, actions which Carter strongly objected to and which ultimately caused Carter to resign in 2003

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10

- Because Carter managed a charity that lost its status for substantial non-compliance, Carter is now an "ineligible individual"
- He is an ineligible individual for the period of 5 years from the date of revocation in February 2007
- The charitable status of Charity X could now potentially be revoked because an ineligible individual was/on its board of directors

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11

- The Budget states that CRA will look at the "particular circumstances" of a charity or RCAAA but does not state what those circumstances are
- The budget does state that CRA will take into account whether "appropriate safeguards have been instituted to address any potential concerns"
- However, there is no explanation of what these safeguards might be

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12

C. INTERNATIONAL CONTEXT

1. New Zealand

- The registration of charities is fairly new
- The Charity Register, administered by the Charities Commission, was created by the *Charities Act 2005* in 2007
- Registration entitles a charity to be exempted from paying tax, but does not necessarily allow it to issue donation receipts
- In order to issue donation receipts, charities must be approved for donee status by New Zealand Inland Revenue, under the *Income Tax Act 2007*

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13

- In order to be granted donee status, an organization:
  - must use its funds primarily for charitable, benevolent, philanthropic or cultural purposes
  - must generally use its funds in New Zealand and
  - must not provide any private benefits to members
- Note that benevolent and philanthropic organizations need not be charitable at law to be donees; and organizations that are charitable at law may not qualify as donees

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14

- Even though registered charities are not automatically donees, as a practical matter, whether a charity is registered can significantly impact its donee status because:
  - Inland Revenue automatically considers registered charities for donee status if donations are part of their income and
  - So long as registered charities spend their funds within New Zealand, Inland Revenue will grant donee status

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15

- Since its inception, the *Charities Act 2005* contained provisions that disqualified certain persons from being on boards of directors or governing bodies of charities
- However, an amendment enacted in 2012 extended the disqualification to individuals in a position to have significant influence over a charity's management or administration, including staff and volunteers

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16

- The *Charities Act* provides that a person is not eligible to hold a position of substantial control (as volunteer, staff or director) if the person:
  - has been convicted of a crime involving dishonesty and has been sentenced for that crime within the last 7 years; or
  - has been disqualified by the Charities Commission upon the deregistration of a charity in which the individual held a position of substantial control
- However, the Charities Commission has the power to waive an individual's disqualification

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17

- Charities must certify that all of their officers are "qualified" in order to obtain charitable registration
- Charities must notify the Charities Commission if an officer becomes disqualified
- Registered charities will cease to qualify for registration if a disqualified officer is in place

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18

2. United Kingdom

- Charities are regulated by the Charity Commission under the *Charities Act 2006*
- The Commission maintains a charity register and regulates the conduct of charities
- Tax relief for charities is administered by Her Majesty's Revenue and Customs (HMRC), under the *Finance Act*
- The *Finance Act* limits which individuals can be "managers" in a charity through its definition of the term "charity"
- Managers are individuals who have general control and management of the administration of the organization

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19

- The *Finance Act 2010* provides that in order for an organization to be a "charity", its managers must be "fit and proper"
- The term "fit and proper" is not defined, but the HMRC does provide a list of factors that may lead it to decide that a person is not "fit and proper":
  - A history of tax fraud
  - A history of other fraudulent behaviour including misrepresentation and/or identity theft
  - Attacks on or abuse of the tax repayment systems
  - Being barred from acting as a charity trustee by a charity regulator or court, or being disqualified from acting as a company director

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20

- However, HMRC has further indicated that there may be other unlisted factors that it may consider in determining if a manager is "fit and proper"
- The position that a person holds within an organization is significant in applying the "fit and proper" test
  - The test applies to all directors and employees who are able to determine how the charities funds are spent
  - If the person has no control over the spending of charitable funds they will not qualify as a manager, even if they are not "fit and proper"

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21

- HMRC also has discretion to treat an organization as properly meeting the definition of "charity", even if one or more managers are not "fit and proper", where it is just and reasonable to do so
- This may occur where a charity unknowingly appoints someone who is not "fit and proper" to a management position, but the charity subsequently moved the individual or implements close supervision in relation to the person's financial activities

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22

D. CONSTITUTIONAL LAW PERSPECTIVE

- The *Constitution Act, 1867* divides powers between those under the legislative authority of Parliament and those under authority of a province
- The management of charities, likely to include the power to prescribe their governance, falls under a provincial head of power
  - Subsection 92(7) of the *Constitution Act, 1867* provides that the legislature of each province may exclusively make laws in relation to the establishment, maintenance and management of charities in and for the province

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23

- The "ineligible individual" provisions are implemented by the federal government through the exercise of its power over taxation and the *Income Tax Act*
- So, the following questions arise:
  - In implementing the "ineligible individual" provisions, is the federal government validly exercising its power over taxation?

    or
  - Is it overstepping its authority by prescribing rules regarding the management of charities, a power that properly resides with the provinces?
- If the Courts were to decide the latter, the provisions would be declared *ultra vires* and therefore invalid

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24

- To determine the constitutionality of a provision that intrudes on the powers of the other legislator, the Court undertakes a "pith and substance" analysis
  - What is the true matter to which the provisions relate: taxation or the management of charities
  - Examine both the purpose and effect of the provisions
- The purpose of the provisions is described by the federal government in its Budget Plan as "[to] safeguard charitable assets through good governance"

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25

- The effect of the provisions is to regulate charities because they risk losing their status if they do not abide by the rules for director and manager eligibility
- Therefore, in "pith and substance" the provisions could be considered to relate to managing charities and not taxation

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26

- The Court would next look at the "ancillary powers doctrine"
  - This doctrine allows a provision to be upheld, despite its encroachment on the power of the province, by virtue of its connection to a valid legislative scheme
  - Where an intrusion on the power of the province is substantial, the provision will have to be "necessarily incidental to statute" and where the intrusion is less serious, the provision will have to have a "rational and functional" connection to the statute

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27

- The Courts have provided a non-exhaustive list of factors to consider in order to determine the severity of an intrusion on power:
  1. The scope of the heads of power in play (whether they are broad or narrow powers)
  2. The nature of the impugned provision (how seriously it effects the province's power, whether it creates rights and whether it is meant to coexist with or replace the powers of province)
  3. The federal government's history of legislating on the matter in question

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28

1. The scope of the powers in play
   - The intrusion on a narrow power is more serious, as it may entirely obliterate the power of the province
   - The regulation of charities is a narrow head of power
2. The nature of the provisions
   - The intrusion is so significant that it does not appear to supplement the provincial power, but to supplant it
   - There is no indication that the provisions were meant to operate in conjunction with the province
3. History of legislating on the matter
   - The intrusion is less serious if there is a history of legislating
   - There is no history of legislating on the internal governance of or employment within charities

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29

- This analysis of the severity of the intrusion on the power of the province establishes the possibility that the Court would find the intrusion to be substantial
- If the intrusion is substantial, the provision will not be valid unless it is "necessarily incidental" to its statute
- The *Income Tax Act* is designed to raise money through taxation, and as such, it is unlikely that the "ineligible individual" provisions would be considered "necessarily incidental"

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30

E. CONCLUSION

- The "ineligible individual" provisions will impose a substantial compliance burden on charities
- What sort of due diligence will be required by a charity to ensure that an "ineligible individual" does not become involved or continue to be involved in the management of the charity?
- The Budget states that a charity will not be required to conduct background checks, but even if the charity wanted to, out of an abundance of caution, the information required to independently assess whether an individual is "ineligible" may not be publicly or easily available

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31

- Possible to search for relevant criminal offences in Canada, but abroad?
- Many relevant offences are not tracked in publicly available databases in Canada, and unlikely abroad
- Names of Board members and like officials of revoked charities not maintained in a single database
- Not likely that "an individual who otherwise controlled or managed the operation" would be identified in publicly available documents – likely information solely in CRA's control

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32

- Since most of the information is only available to CRA, the onus should be on CRA to maintain a list of "ineligible individuals" (which may exist internally for the purpose of enforcing these provisions) and making it publicly available (unlikely because of privacy and other legal concerns)
- Onus is shifted to charities to comply in a situation where it is impossible to ensure 100% compliance because the necessary information is not available
- This new cause for revocation is similar to a strict liability offence – no due diligence defence is available in the legislation

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33

- Instead charities will be relying on CRA to exercise discretion
- One issue that charities will need to address is whether a questionnaire is necessary and if so, how frequent is a questionnaire to be used, how broad should the questions be and to whom should it apply?
  - Likely all directors, trustees, officers and like officials
  - Who is an individual who otherwise controls or manages the charity - likely all senior staff ?

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34

- How does a charity deal with a director or officer that is an ineligible individual – usually only the members or directors can remove a director?
- How does a charity remove staff that is an ineligible individual – could have important employment law ramifications?
- This increased compliance burden has been justified on the basis that charities should be held to a higher standard because they are supported by public funds
- It remains to be seen whether the ends will justify the "ineligible individual" provisions

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