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**Fiduciary Considerations
Involving Charitable Property**

**By Kenneth Goodman, B.A., LL.B. - Deputy Public Guardian & Trustee,
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**Fiduciary Considerations
Involving Charitable Property**

**2010 Annual Church & Charity
Law Seminar**

By Kenneth R. Goodman,
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**THE WICKED
WITCH.....**




IS DEAD



BUT WAS SHE ALWAYS WICKED?

Trust Law v. Tax Law




Trust Law


- o Guidelines of how you carry out your duty
- o Established over time by English and Canadian common law

Tax Law

- o Prescribed courses of actions and requirements with detailed and, at times, complicated rules




Roles of the Public Guardian and Trustee and the Canada Revenue Agency



PGT

- o Monitors compliance with laws re proper use of charitable assets and ensures trustees carry out fiduciary duties
- o No annual filing but initial report and when information changes
- o No power to revoke charitable status can apply to court if property misused
- o Court can make order requiring fiduciaries (Directors) to repay any misused property.




CRA


- o Focus on tax law and tax principles to prevent abuses of the charitable donation tax credit system including disbursement quota and receipt system
- o Requires filing of annual return (T3010)
- o Can revoke registration or administrative penalties e.g. fines or loss of receipting privileges.

Source of Law in Canada:
1) Statutes and Regulations

- **Statute and regulations:**
- Laws drafted by government
- E.g. Income Tax Act, Charities Accounting Act, Trustee Act, etc.




Source of Law in Canada:
2) Common Law



- Judges interpret and apply statutes and regulations to cases that they hear
- Judges may also apply the legal principles from previous court decisions to their cases
- Judges write their decisions based on their interpretation and application of the statutes and regulations and the legal principles from previous court decisions
- The compilation of these decisions is known as "common law", "case law", "jurisprudence" or "precedent"



Definitions – "Trust"

- **A "Trust" is:**
- A way of holding property for the benefit of someone else with legal and equitable obligations imposed on the holder
 - Obligations and conditions as to how, when, where and for whom or what purpose the property is held



Definitions – “Trustee” and “Trust Property”


- “Trustee” – a person who is holding the title to the trust property for the benefit of the beneficiaries
 - This could be an individual, a bank, a trust company, etc.

- “Trust Property” – any kind of right or asset can be held in trust

Definitions – “Fiduciary Duty”


- “Fiduciary Duty” – a legal duty of loyalty and faithfulness towards another person
- Comes from the Latin word “fiducia”, which means “trust”
- “Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:
 - (1) The fiduciary has scope for the exercise of some discretion or power.
 - (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interests.
 - (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.”



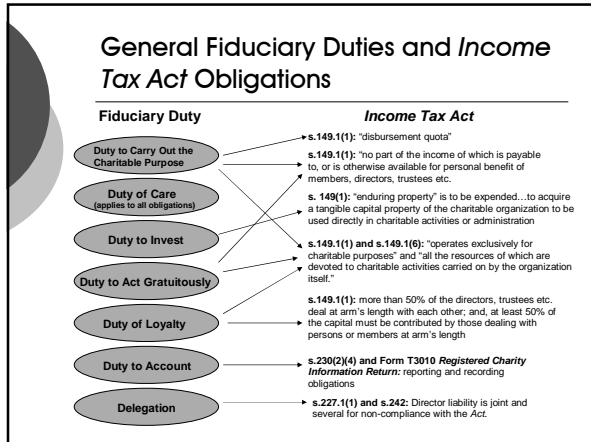
... Supreme Court of Canada in *Frame v. Smith*, [1997] 2 S.C.R. 99 at 136

Categories of Fiduciary Relationships

- Duty owed by trustees to the beneficiary
- Others in a position of authority or power also owe this duty to those who are subject to their authority or power
 - “Some recognized examples of these categories are relationships between **directors and corporations**, solicitors and clients, **trustees and beneficiaries**, agents and principals, life tenants and remaindermen, and **partners**. As well, it has frequently been noted that the **categories of fiduciary relationship are never closed** ... An extension of fiduciary obligations to new “categories” of relationship presupposes the existence of an underlying principle which governs the imposition of the fiduciary obligation.”




-- *Frame v. Smith*



What Fiduciary Duties Apply to Directors of Charitable Corporations:

All Corporations:

- *Canadian Aero Service Ltd. v. O'Malley* [1973] S.C.R. 592
- Supreme Court of Canada found that the role of the fiduciary applies to directors and senior management officials of corporations




Charitable Corporations:

- Courts originally held the following:
 - 1) The charitable corporation holds its property in trust for the charitable purposes; and
 - 2) Directors of charitable corporations are trustees.

Current Position:

Overtime these concepts have been refined:

- The charitable corporation does not hold all their property in trust for charitable purposes.
- Directors are not trustees, but are high order fiduciaries with similarities to trustees.
- Charitable corporations are hybrid entities in law, subject to both corporate and charities law.




Conflict of Interest


- o "Fiduciary responsibilities include the duty of loyalty, of which an element is the avoidance of conflicts of interest."
 - -- *Strother v. 3464920 Canada Inc.*, [2007] 2 S.C.R. 177.
- o A conflict of interest arises when a fiduciary attempts to promote his or her private or personal interest in a manner that results in:
 - o (a) interference with the exercise of his or her duties of loyalty and honesty for the benefit of the beneficiaries, or
 - o (b) a gain or advantage for the fiduciary by virtue of the fiduciary's position of trust and loyalty to the beneficiary.

Conflict of Interest – Cont'd

- o A fiduciary cannot personally benefit from his or her duties to the beneficiary
- o To be advised that one is in a conflict of interest is not necessarily an accusation that a fiduciary has done something wrong. **A conflict of interest can exist even if no unethical or improper act results.**
- o A conflict of interest can create an **appearance of impropriety** that can undermine confidence in the fiduciary's ability to act in accordance with his or her duty of loyalty and honesty owed to the beneficiary.
- o "A conflict of interest may arise, whether or not:
 - o (a) financial advantage has been or may have been received;
 - o (b) the judgment of the person has actually been affected or impaired by the conflict;
 - o (c) the conflict is actual or perceived;
 - o (d) there is an intention to obtain a personal benefit, either directly or indirectly;
 - o (e) there is any willful wrongdoing."
- o -- *Peel (Regional Municipality) v. Greater Toronto Airports Authority*, [1999] O.J. No. 3597 (Ont. Sup. Ct. J.)(OL).




Remuneration of Directors:



"It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict."

- Lord Herschell, *Bray v. Ford* [1896] A.C. 44

The Law in England



Leading Cases:

Re French Protestant Hospital [1951] 1 All ER 935:

"Lord Herschell clearly recognized that in some cases it may not be improper to have a provision, sometimes described as a charging clause, which enables trustees to be paid, and one is to be paid for their services, but, while it is entirely proper for a settlor or testator to insert in his settlement or will a provision enabling the trustees of a trust constituted by him to obtain payment for their services, it seems to me a very different matter for persons who are already in the position of trustees, and therefore, so far as they exercise their powers at all, bound to exercise them in a fiduciary manner on behalf of the charitable trusts in which they act, to empower themselves to be at the one time trustees and persons who are making a profit."

Smallpiece v. Attorney General [1990], from the Great Britain, Charity Commission, *Report of the Charity Commissioners for England and Wales for the year of 1990*, (London: HMSO)


- Commission found it was not appropriate to set up a subsidiary trading company in order to pay directors for services provided to the trading company.

The Law in England cont'd

Charities Act, 2006


Discussions over changes to the *Act*:

Charity Commission Seminar:
"Trustee Remuneration: Views from the Sector"



- 1) Delegates distrusted the idea of paying trustees, and asked to look at "whether it is in the best interests of the charity, regardless of a charity's financial and lawful ability to pay trustees."
- 2) Delegates felt that if there was to be any decision to pay trustees it should be "open and transparent at all stages and that proper management of conflict of interest is essential."

The Law in Ontario



Leading Case:

Public Trustee v. Toronto Humane Society et. al [1987] O.J. No. 534

Status of Directors:

"Without going the length of holding that the Society is in all respects and for all purposes a trustee, I have concluded that it is answerable in certain respects for its activities and the disposition of its property as though it were a trustee."


Quoting from *Re French Protestant Hospital*:

"Addressing the status of the directors, Dankewerts J. says at p.570 "...it seems to me plain that they are, to all intents and purposes, bound by the rules which affect trustees'. I am in respectful agreement with that conclusion and deem it applicable to the remuneration of the Society."

Court's Jurisdiction:


"There is broad inherent jurisdiction in the court in charitable matters exercisable by virtue of its special position in the law of charities."

"...I am satisfied that it is amenable to the ancient supervisory equitable jurisdiction of the court"

The Law in Ontario cont'd 

Other cases that have followed *Toronto Humane Society* in Ontario:

- *Re David Feldman Charitable Foundation* [1987] O.J. No. 1432
- *Re Faith Haven Bible Training Centre* [1988] O.J. No. 969
- *Harold G. Fox Education Fund* [1989] O.J. No. 1085

The Law in Canada 

***Toronto Humane Society* followed outside of Ontario:**


Yukon Youth Centre Society v. Leonard [1994] Y.J. No. 90

Justice Hudson quoting from *Toronto Humane Society*:

"As regards the directors, they were at the very least, fiduciaries, and owed a fiduciary obligation to the society. When two of them received a substantial salary from the society, their interest and duty conflicted."

Duty to Invest: Impact of recent legislative changes in Ontario

- *Trustee Act* – investment powers
- Prudent investors
- Legislative changes – *Good Government Bill*



Duty to Invest – Part of Fiduciary Duty

Duties and Powers to Invest under sections 26-31 of the Trustee Act:

Prudent Investor Standard

- **S. 27(1)** In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments. 1998, c. 18, Sched. B, s. 16 (1).

Authorized investments

- **S. 27(2)** A trustee may invest trust property in any form of property in which a prudent investor might invest

Diversification

- **S. 27(6)** A trustee must diversify the investment of trust property to an extent that is appropriate to,
 - (a) the requirements of the trust; and
 - (b) general economic and investment market conditions

Terms of trust


- **S. 27(9)** This section and section 27.1 do not authorize or require a trustee to act in a manner that is inconsistent with the terms of the trust

Trustee's duty if delegating functions to an agent

- **S. 27.1(4)** A trustee is required to exercise prudence in selecting an agent, in establishing the terms of the agent's authority and in monitoring the agent's performance to ensure compliance with those terms.

Investment Plan or Strategy Recommended


- **28.** A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.




Factors to consider when investing trust property: s. 27(5)

Criteria

- **S. 27(5)** A trustee must consider the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:
 1. General economic conditions.
 2. The possible effect of inflation or deflation.
 3. The expected tax consequences of investment decisions or strategies.
 4. The role that each investment or course of action plays within the overall trust portfolio.
 5. The expected total return from income and the appreciation of capital.
 6. Needs for liquidity, regularity of income and preservation or appreciation of capital.
 7. An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.



Good Government Bill



Charities law in Ontario has its roots in English Law and dates back to the Statute of Elizabeth in 1601.

Changes in this area of law do not happen very quickly. There have been a number of improvements. Up to now these have been small but important improvements.

Good Government Bill – Cont'd

Some of these changes were included in the *Good Government Bill, 2009* which came into effect on December 15, 2009. This very long overarching bill affects over 26 Ministries. The OPGT alone had over 20 amendments in this Act.

The Charities Law Amendments covered three areas:

1. Ownership and use of Real Estate by charities;
2. Ownership of for profit businesses by charities; and
3. Ability to capitalize income after a trust has been in existence for 21 years.

Good Government Bill – Cont'd

The overall purpose of the reforms is to reduce regulatory burdens on charities operating in Ontario, while at the same time ensuring charities use the property they hold for its intended propose, carrying out the charitable purposes.



I will only speak to two major amendments.

Good Government Bill – Cont'd

Real Estate



Former section 8 of the *Charities Accounting Act* required that any land owned by a charity must be actually used or occupied for charitable purposes.

Current Version:

Limitation on use of property

- o **8.** A person who holds an interest in real or personal property for a charitable purpose shall use the property for the charitable purpose



Good Government Bill – Cont'd

If land was held in contravention of the Act, the Public Guardian and Trustee had the authority to vest the land in her name, with the power to sell the land and use the proceeds for the charities' charitable purposes.



The new Act states that all property owned by a charity must be used to benefit the charitable purposes. With the amendment to section 8 of the *Charities Accounting Act*, real property would be treated no differently than personal property. Any property not needed for immediate use could be invested in accordance with the *Trustee Act*. Holding land will no longer be any different than holding any other investment.

Good Government Bill – Cont'd

Those who hold an interest in real or personal property will have to ensure their investments comply with the prudent investor standards set out in the *Trustee Act*. It is now allowed, under the *Charities Accounting Act*, to hold real estate for any length of time as long as holding that real estate meets the prudent investor rules and benefits the charity.



There were also amendments to *Religious Organizations Land Act* which allows unincorporated Religious organizations to lease their land without any time limit restrictions.

Good Government Bill – Cont'd

Business Interest

The other major change is the repeal (i.e. cancellation) of the *Charitable Gifts Act*.




The *Charitable Gifts Act*, which was enacted in 1949 was unique to Ontario, prevented charities from owning more than 10% of the shares in a business. Now charities are able to own a substantial interest in a business.

There were also changes to the *Charities Accounting Act*, providing the PGT and the Court with the necessary tools to look into the operations of any business in which a charity has a substantial interest.



Conclusion



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