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CHARITY & THE LAW UPDATE TM*

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Updating Charities and Not-For-Profit Organizations on recent legal developments and risk management considerations

IN THIS ISSUE

This issue of *Charity & the Law Update* contains the following articles:

EDITORS NOTE

Charity & The Law Update is published by Carter & Associates without charge for distribution to charities and not-for-profit organizations across Canada and internationally. It is published approximately 3 times a year as legal developments occur. The format is designed to provide a combination of brief summaries of important developments as well as feature commentaries. Where a more lengthy article is available on a particular topic, copies can be obtained from our website at www.charitylaw.ca. The information and articles contained in this *Charity & The Law Update* are for information purposes only and do not constitute legal advice and readers are therefore advised to seek legal counsel for specific advice as required.

1. Utilizing Ten Year Gifts in Charitable Fund Raising

BY TERRANCE S. CARTER, B.A., LL.B.

Ten year gifts to charities are becoming an important tool in charitable fund raising, both for charities and donors. They assist charities by being exempt from the 80% disbursement requirement that applies to donations received in the previous year. They assist donors by facilitating the giving of gifts that are to be held for a longer term, whether it be for a minimum of ten years or for longer, such as a perpetual endowment fund. However, there are many legal issues involving ten year gifts that are not well understood by charities for which the advice of lawyers should be sought. The following is a brief overview of some of those issues.

DOCUMENTING TEN YEAR GIFTS

The fact that a ten year gift can include a directed gift as well as a charitable trust means that gifts to a charity that may not meet the requirements to create a charitable purpose trust may still constitute a ten year gift where the requirements to document a ten year gift under the *ITA* have been met.

Subsection 149.1(1) of the Income Tax Act (*ITA*) sets out what constitutes a ten year gift. The relevant provisions are as follows:

> *...a gift subject to a trust or direction to the effect that property given, or property substitutes therefore, is to be held by the foundation* [charitable organizations] *for a period of not less than ten years...*

Each ten year gift must be evidenced by a document signed by the donor. The documentation must:

- clearly identify the donee charity, including its official name and registration number;
- indicate the amount of the gift;
- set out the date the gift is made;
- set out the name and address of the donor; and
- set out the serial number of the official receipt issued to the donor for the gift.

The documentation should then be attached to the charity's duplicate copy of the receipt and retained with its other books and records.

The requirement that a ten year gift must be a trust or a direction that is executed by the donor may be problematic when dealing with a public fund raising event, such as a dinner or auction, where the proceeds are to be added to an endowment or other type of ten year gift. It is not realistic to expect that each person attending the event would be prepared to sign a direction or declaration of trust. A solution might be for the event's promotional materials to set out the requirements to establish a ten year gift and to include a reply card to buy tickets stating that the completion and signing of the card is deemed to be the execution of a ten year gift document, or alternatively to include all of the relevant information about the ten year gift on the back of the tickets provided that the purchasers sign their tickets and the charity retains a duplicate copy

EXPENDITURE OF INCOME BY FOUNDATIONS

Ten year gifts remain subject to the 4.5% annual disbursement quota imposed on foundations. Unless a foundation has other income to meet the 4.5% disbursement quota on ten year gifts that it holds, it is essential that the ten year document permit the income earned on the gifts to be expended each year, and also that the annual income earned on the gift be at least 4.5% of its original value plus any resulting capital gains.

Sub-section 149.1(1) requires a ten year gift to remain intact for ten years. This means that a partial disbursement of capital to meet the quota is not permitted. Therefore, before accepting a ten year gift, a foundation must be satisfied that the gift will earn sufficient income to meet the 4.5% disbursement quota. If not, the board cannot disburse a portion of the capital to meet the quota. Instead, it should not accept the ten year gift.

A related question is whether the document creating a ten year gift can authorize the expenditure of capital gains earned on the gift by defining "income" to include resulting capital gains. In this regard, CCRA has recently stated that capital gains earned from a gift are considered to be a portion of the *"property given, or property substituted therefore"* under ss.149.1(1) of the *ITA* and that no capital gain earned on a ten year gift can be disbursed for at least ten years.

As a result, it is important for charities that may have ten year gift documentation permitting the disbursement of capital gains not to exercise that option; otherwise, the charity would be in violation of the definition of a ten year gift under ss.149.1(1) of the *ITA.*

CONSEQUENCES OF EXPENDING CAPITAL PRIOR TO EXPIRY OF TEN YEARS

If the capital of a ten year gift, i.e. *"property given or property substituted therefore"* under ss.149.1(1) of the *ITA*, including capital gains ("Capital"), is expended within ten years of the gift being made, certain consequences would result:

- The expenditure would be a breach of trust or a violation of the donor direction creating the ten year gift.
- The portion of the Capital expended would be added to the disbursement quota of the charity for the year in which the Capital was expended in accordance with the definition of the disbursement quota under ss.149.1(1) of the *ITA*. This, in effect, would mean that the amount of the Capital expended would be added to and disbursed as part of the disbursement quota in the same year, resulting in a neutral effect upon the disbursement quota of the charity for that year.
- The more difficult question is whether the full amount of the ten year gift collapses where only a portion of the Capital is expended in any one year. This would not appear to be the case from the wording of ss.149.1(1), in that the amount added to the disbursement quota is based upon the actual amount that is expended in a particular year. As such, if only ten percent of a ten year gift were disbursed in a year, it would appear that only the ten percent actually expended would be added to the disbursement quota.
- Based upon the above, some charities have considered gradually disbursing a ten year gift over a number of years, assuming that there would be no

negative impact upon meeting its disbursement quota each year. However, CCRA may see a gradual disbursement as an intentional misuse of the ten year gift, which might result in either deregistration of the charity or, alternatively, disallowance of the ten year gift in the original year in which it was claimed for the full amount of the gift that had been exempted.

EXPENDITURE OF TEN YEAR GIFTS AFTER EXPIRY OF TEN YEARS

The ten year gift exemption only requires that a gift be held for *"not less than ten years."* Therefore, a trust or direction could create a ten year gift that is to be held for longer than ten years, or even in perpetuity as an endowment. In this regard, the donor could direct how the gift is to be expended after ten years. Silence on this issue by the donor would give the charity liberty to use the gift as the charity determined at the end of ten years, regardless of the donor's intentions.

Conversely, a gift listed as a ten year gift on a charity's annual return does not necessarily mean that the gift can be expended after ten years. The charity and its board of directors would need to carefully review the wording creating the gift to determine if any restrictions continue after ten years, such as the gift being held is perpetuity as an endowment.

MANAGING TEN YEAR GIFTS

Charities often co-mingle restricted funds in a single account for investment purposes. Although this practice may be authorized by pending regulations under the *Charities Accounting Act* of Ontario, it is prudent for charities to maintain each ten year gift in a separate account. Although administratively awkward, this practise would help to ensure the following:

- Since the Capital of a ten year gift, including any resulting capital gains, cannot be expended for at least ten years, a charity must be able to identify the original gift and the capital gains earned thereon.

- There would be less chance that the capital of the gift would be expanded during the ten years in an attempt to meet the 4.5% disbursement quota.

- Since each donor may impose different terms on a ten year gift, i.e. length of time the gift must be held, or the investment powers that are to apply, maintaining separate accounts for each ten year gift would help the charity to keep track of and comply with the specific terms of each gift.

2. Supreme Court's Refusal To Grant Leave To Appeal In Christian Brothers Case Prejudices Charities

BY TERRANCE S. CARTER, B.A., LL.B.

The decision by the Supreme Court of Canada ("S.C.C") on November 16, 2000 denying leave to appeal from the Ontario Court of Appeal decision in *Christian Brothers of Ireland in Canada (Re)* 2000, 47 O.R. (3d) 674 (Ont. C.A.), ("Ont. C.A. Decision") has caused confusion for charities and will prejudice the financial viability of the charitable sector in Canada. In permitting tort creditors to seize special purpose charitable trusts of a charity, the Ont. C.A. Decision will likely become one of the most important decisions affecting charities in Canada in recent memory, primarily due to the negative impact it will have upon major donations to charities.

By exposing special purpose charitable trusts to claims of creditors, the Ont. C.A. has undermined one of the primary means by which charities raise monies from donors. Special purpose charitable trusts used by charities include endowment funds, scholarship funds, building funds, 10-year gifts under the *Income Tax Act*, donor advised funds placed with community foundations, and testamentary gifts where the testator imposes restrictions on the use of funds. As donors become more sophisticated with their giving and demand more accountability from charities, the use of special purpose charitable trusts is becoming more and more a major fundraising vehicle, particularly for donors making large gifts to charities. However, as a result of the Ont. C.A. Decision, charities will now be unable to assure donors that special purpose charitable trusts will be protected and accordingly, this important means of fundraising will likely be curtailed in the future.

An earlier commentary on the impact of the Ont. C.A. Decision and possible strategies that may be developed in response to the decision are contained in an article by the author included in the June 30, 2000 issue of *Charity & the*

Law Update available at www.charitylaw.ca, as well as in a longer article by the author entitled "*Donor Restricted Charitable Gifts: A Practical Overview Revisited*" dated November 22, 2000, also available at www.charitylaw.ca.

Some additional comments concerning the rationale of the Ont. C.A. Decision and its long- term impact upon charities are set out below as follows:

- Although not specifically stated in the Ont. C.A. Decision, the rationale by which the Court has been able to conclude that special purpose charitable trusts are exigible, without at the same time blatantly contradicting established principles of trust law in relation to the protection of trust property, is to make a distinction between private trusts and charitable trusts. There appears to be an underlying assumption by the Ont.C.A. that a special purpose charitable trust held by a charity as trustee is tantamount to a trustee holding property in trust for itself, thereby precluding a trust in the first place. This line of reasoning comes from a misconception that special purpose charitable trusts do not have identifiable beneficiaries to enforce a charitable purpose trust. Therefore, it is as if the charity is holding the charitable property in question for itself, subject only to a trustee-like fiduciary obligation to comply with the requirements of the donor.
  While the Ont. C.A., and counsel who advocated the position before the Court, failed to recognize is that a basic attribute of a charitable purpose trust is that it is a unique trust that is exempt from the requirement that there be identifiable beneficiaries. The reason why special status is given at law to a charitable purpose trust is that the public-at-large receives the benefit of a charitable purpose and as such are collectively considered to constitute the beneficiaries of the trust. Since it would be impossible for all members of the public to enforce the trust, it falls upon the Attorney General on behalf of the Crown to enforce the terms of the charitable purpose in accordance with its *parens patriae* role in overseeing charitable property. Given that a charitable purpose trust is recognized at law to be as much a valid trust as a private trust, it follows that the decision by the Ont. C.A. in allowing tort creditors to seize property held by a charity in a special purpose charitable trust could arguably mean that any trust property held by a trustee, including trust property held pursuant to a private trust, might be subject to claims against the trustee personally. Since such a result would be inconceivable as contradicting established principles of private trust law, the same should be true in relation to charitable purpose trusts.

- The Ont. C.A. Decision may result in discriminatory treatment between otherwise identical special purpose charitable trusts. Some special purpose charitable trust documents include wording that permit the trust to be amended in order to ensure that the trust property can continue to be used for the intended charitable purpose, similar to what a court can do pursuant to its inherent *cy-prés* scheme making power. An example would be the inclusion of a clause in a charitable trust document stating that if the special purpose charitable trust in question becomes impossible or impracticable to carry out, the trustee may apply the fund to another similar charitable purpose without the necessity of obtaining a court order. Practically, this would mean that a charity facing insolvency, a winding up order, or bankruptcy, that was holding a special purpose charitable trust may be able to transfer the fund to another charity and thereby protect that fund. However, the majority of special purpose charitable trusts, particularly testamentary trusts drafted before the mid nineteen-nineties, would not likely have included adequate *cy-pres* clauses and therefore will now be susceptible to claims by tort creditors.

- Discriminatory results may also occur between perpetual endowment funds given to incorporated entities and those given to incorporated charities. The Ont. C.A. Decision has raised the question whether charitable purpose trusts require identifiable beneficiaries who are distinct from the charity as trustee. If so, the decision leaves in question whether charitable purpose trusts are in fact real trusts at all as opposed to constituting a trustee-like fiduciary obligation only. This in turn adversely affects the validity of perpetual endowment funds given to charities that are unincorporated associations. A gift of an endowment fund to an incorporated charity is not dependant upon the gift being a special purpose charitable purpose trust, since a charitable corporation can hold property in accordance with its corporate objects whether or not there is a charitable purpose trust. However, unincorporated charities do not have the legal capacity to receive gifts absolutely, as they are not legal entities at law. In order to overcome the rule against perpetual ownership of trust property, gifts of perpetual endowment funds to unincorporated charities can only be valid if the gift constitutes a charitable purpose trust. Since the Ont. C.A. Decision has called into question whether charitable purpose trusts exist at law, the validity of perpetual endowment funds to unincorporated charities may now be left in doubt. This may lead to increased estate litigation involving gifts of endowment funds to unincorporated charities, such as testamentary endowment funds to local churches and other small charities.

- Many lawyers who have advised charities and/or donors that special purpose charitable trusts are exempt from claims against a charity will now have to explain why gifts that had previously been given by donors, and were presumed to be protected from claims as trust property, are now not protected. In the future, lawyers may be found liable if they fail to advise clients, both charities and/or donors, that special purpose charitable trusts are no longer protected from the claims of tort creditors and that alternatives should be canvassed in an attempt to "credit-proof" special purpose charitable trusts where possible.

Given the serious impact that the Ont. C.A. Decision has had upon charities, it is regrettable that leave to appeal to the S.C.C. was not granted. The only practical alternative is to seek legislative protection for special purpose charitable trusts through remedial legislation at the provincial level. Given the serious impact that the Ont. C.A. Decision will have upon charities, it is hoped that provincial governments will be receptive to legislative initiatives in this regard in order to ensure the long-term financial stability of the charitable sector in Canada.

3. The Effect of New Regulations under the Charities Accounting Act

BY TERRANCE S. CARTER, B.A., LL.B.

Background to Regulation

Regulation 04/01 was adopted under Section 5.1 of the *Charities Accounting Act* by the Public Guardian and Trustee of Ontario ("PGT") on February 3rd, 2001 ("the Regulation"). A copy of the Regulation is attached to this Bulletin as an Appendix. The Regulation had been anticipated ever since Section 5.1 of the *Charities Accounting Act* was passed in 1996. Section 5.1 authorized the adoption of regulations by the Attorney General to permit certain prescribed activity involving charitable property that would otherwise have required the approval of the Superior Court of Justice, including the following:

- permitting directors to receive remuneration from charities on whose Boards of Directors they sit;
- permitting charities to indemnify trustees, executors, directors and officers for personal liability arising out of their offices, as well as to purchase directors and officers liability insurance; and
- allowing charities to co-mingle multiple restricted funds held by the charity into a single account or investment portfolio.

No Relief To Common Law Rule Prohibiting Directors From Receiving Remuneration:

Unfortunately, the Regulation that was adopted does not authorize directors and trustees to receive any remuneration from the charity on which they serve. Therefore, the common law rule in Ontario still applies, i.e. that directors of a charity, in their quasi trustee role, have a fiduciary obligation not to put themselves into a conflict of interest by receiving remuneration, either directly or indirectly, from the charity for which they serve as a director. The Public Guardian and Trustee has indicated that further regulations dealing with this issue may be passed in the future but, for now, the current common law in Ontario continues to apply. Consequently, it will continue to be necessary for the Board of a charity and its legal counsel to ensure that the charity's by-laws and other constating documents do not permit the remuneration of directors other than for reimbursement of out of pocket expenses.

Some of the consequences arising of the new Regulation failing to authorize the remuneration of directors are as follows:

- charities may continue to find it difficult to attract qualified candidates to their Boards of Directors where those candidates are providing goods and services to the charity, either at or below market value, such as inexpensive or pro-bono services by a lawyer or accountant.
- Some religious charities may find it theologically unacceptable for doctrinal reasons that their minister cannot be a member of the controlling Board of the church simply because the minister receives remuneration from the church. In those situations, it may be necessary for churches or other religious organizations to make an application for a consent order from The *PGT* under section 13 of the *Charities Accounting Act* to permit such payment.

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or those charities that do not want to go to the trouble or expense of obtaining a consent order from the *PGT*, an alternative would be to structure the by-law and other constating documents of the charity so that the employee in question, such as an executive director, will not be a member of the Board of Directors but will be given substantive rights over the day to day operations of the charity, including the right to receive notification of all Board meetings, be present at all Board meetings, and participate at all Board meetings (save and except when such Board meetings are dealing with the position of the Executive Director), but without such person being a member of the Board of Directors. For a more detailed discussion concerning issues involving remuneration of directors, see articles by the author entitled *"Remuneration of Directors in Ontario"* and *"Update on Remuneration of Directors in Ontario"* available at *www.charitylaw.ca.*

Indemnification of Directors and Officers and Liability Insurance:

Under the Regulation, a charity may indemnify a trustee or executor or, where the executor or trustee is a corporation, indemnify the directors or officers of the corporation for personal liability arising from an act or omission in performing his or her duties. However, a charity may not indemnify a director or officer for liability arising from a failure to act honestly and in good faith in performing those duties.

The ability of a charitable corporation to adopt an indemnity by-law had been in question as a result of an error in the wording in previous amendments to the *Corporations Act*. However, this omission has recently been corrected through a further amendment to the *Corporations Act* which now ensures that Ontario non-share capital corporations can indemnify their directors and officers, provided that the requirements of the Regulation adopted under the *Charities Accounting Act* have been followed.

The Regulation also provides that insurance may be purchased to cover personal liability arising from the act or omissions of the executors, trustees, directors or officers of a charity in performing their duties. However, the terms of the insurance or indemnification must not impair a person's right to bring legal action against the executor, trustee, director or officer. In addition, the Regulation states that the purchase of the insurance policy must not unduly impair the carrying out of the religious, educational, charitable or public purposes for which the charity holds property. The Regulation further states that the executor or trustee, and if the executor or trustee is a corporation, the board of directors of the corporation, must consider the following before giving an indemnity or purchasing insurance:

- The degree of risk to which the executor, trustee, director or officer is or may be exposed;
- Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance;
- Whether the amount or cost of the insurance is reasonable in relation to the risk;
- Whether the cost of the insurance is reasonable in relation to the revenue available to the charity; and
- Whether it advances the administration and management of the charitable property to give the indemnity or purchase the insurance.

The Regulation states that no indemnity may be paid or insurance purchased if to do so would result in the amount of debts and liabilities exceeding the value of the charitable property or, if the executor or trustee is a corporation, render the corporation insolvent. Another limitation is that the indemnity may only be paid or the insurance purchased from the charitable property to which the personal liability relates and not from any other charitable property. This would appear to mean that the income from segregated funds, such as endowment funds, that would otherwise not normally attract potential liability for a director or officer should not be used to purchase directors and officers liability insurance or to pay an indemnity.

The consequences of the Regulation permitting indemnification of directors and officers of a charity and the purchase of liability insurance can be summarized as follows:

- It will be important for the directors of a charity to carefully review all of the Regulation to ensure that the directors are complying with its terms before proceeding with the adoption of an indemnification by-law or the purchase of directors and officers liability insurance.
- If the charity complies with the Regulation, it is important to determine whether the indemnification by-law has been passed and/or insurance has been purchased prior to the publication of the Regulation on February 3rd, 2001. Since the Regulation is not stated to be retroactive, it is possible that an indemnification

by-law adopted prior to the publication of Regulation 04/01 may need to be passed as a new by-law or may require the adoption of a current resolution that the board of directors have reviewed the conditions and terms of Regulation 04/01 and are satisfied that the indemnification in question and/or the purchase of liability insurance complies with the terms and conditions of the Regulation.

- Since charities will in most circumstances now be able to purchase directors and officers liability insurance from the funds of the charity, it will become less problematic to recruit qualified volunteers as directors to its board of directors.

Charities May Co-Mingle Restricted and Special Purpose Funds:

Under the Regulation, a charity may now co-mingle property funds received for a restricted or special purpose with other properties similarly received into a single account or investment portfolio. However, a number of restrictions and obligations are imposed by the Regulation which may make the option of co-mingling funds difficult or impractical. In this regard, a charity that is intending to co-mingle property or funds held or restricted or special purposes:

- May only do so if it advances the administration and management of each of the individual restricted funds;

- Must allocate all gains, losses, income and expenses rateably on a fair and reasonable basis to the individual funds; and

- Must maintain detailed records relating to each individual fund, including the following:

  - the value of the individual fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the value of any portion of the individual fund that does not become part of the combined fund;
  - the source and the value of contributed fund (i.e. additional fund that is added to and forms part of a pre-existing individual fund) relating to an individual fund, and the date on which the contributed fund is received;
  - the value of the contributed fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the amount of the revenue received by the combined fund that is allocated to the individual fund, and the date of each allocation;
  - the amount of the expenses paid from the combined fund that are allocated to the individual fund, and the date of each allocation; and
  - the value of all distributions from the combined fund made for the purposes of the individual fund, and the purpose and date of each distribution.

- Must maintain detailed records relating to the combined fund, including the following:

  - the value of each individual fund that becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the value of each contributed fund that become part of the combined fund;
  - the date on which it becomes part of the combined fund, and the details of the individual funds to which the contributed fund relates;
  - the amount of the revenue received by the combined fund, the amount allocated to each individual fund, and the date of each allocation;
  - the amount of expenses paid from the combined fund, the amount allocated to each individual fund and the date of each allocation; and
  - the value of all distributions from the combined fund made for the purposes of an individual fund and the purpose and date of each distribution.

In light of the double records that must be maintained and the detail required for those records, a charity may decide that it is simpler and less problematic to maintain each restricted or special purpose trust fund in a separate account for investment purposes notwithstanding the likely lower rate of return for the over all portfolio investment of the charity. It is therefore important for the board of directors of a charity to weigh the benefits to be gained from combining restricted and special purpose funds against the significant administrative costs and aggravation of keeping the necessary records in order to co-mingle restricted and special purpose funds. It is also important for the board of a charity to realize that co-mingling restricted or special purpose funds in contravention of the Regulation will expose the directors to allegations of breach of trust and resulting personal liability.

REGULATION MADE UNDER THE *CHARITIES ACCOUNTING ACT*

APPROVED ACTS OF EXECUTORS AND TRUSTEES

Ontario Regulation 04/01
Filed: Jan. 17, 2001
Gazette: Feb. 3, 2001 (proposed)

APPROVAL OF SPECIFIED ACTS

1. (1) The acts authorized by this Regulation that would otherwise require the approval of the Superior Court of Justice in the exercise of its inherent jurisdiction in charitable matters shall be treated, for all purposes, as though they had been so approved.

(2) Subsection (1) does not constitute authorization of an act that conflicts with one of the following in a particular case:

1. The will or the instrument in writing relating to the property.
2. A court order relating to the will or instrument or relating to the property.

(3) An executor or trustee must maintain records demonstrating that he, she or it has complied with the requirements of this Regulation when engaging in an act that is authorized under subsection (1).

(4) An executor or trustee is not required by virtue of this Regulation to give any indemnity or to make any payment.

AUTHORIZATION TO INDEMNIFY

2. (1) In the circumstances and subject to the restrictions set out in this section, an executor or trustee and, if the executor or trustee is a corporation, each director or officer of the corporation may be indemnified for personal liability arising from their acts or omissions in performing their duties as executor, trustee, director or officer.

(2) An executor, trustee, director or officer cannot be indemnified for liability that relates to their failure to act honestly and in good faith in performing their duties.

(3) In the circumstances and subject to the restrictions set out in this section, insurance may be purchased to indemnify the executor, trustee, director or officer for the personal liability described in subsection (1).

(4) The terms of the indemnity or insurance policy must not impair a person's right to bring an action against the executor, trustee, director or officer.

(5) The executor or trustee or, if the executor or trustee is a corporation, the board of directors of the corporation shall consider the following factors before giving an indemnity or purchasing insurance:

1. The degree of risk to which the executor, trustee, director or officer is or may be exposed.

2. Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance.

3. Whether the amount or cost of the insurance is reasonable in relation to the risk.

4. Whether the cost of the insurance is reasonable in relation to the revenue available to the executor or trustee.

5. Whether it advances the administration and management of the property to give the indemnity or purchase the insurance.

(6) The purchase of insurance must not, at the time of the purchase, unduly impair the carrying out of the religious, educational, charitable or public purpose for which the executor or trustee holds the property.

(7) No indemnity shall be paid or insurance purchased if doing so would result in the amount of the debts and liabilities exceeding the value of the property or, if the executor or trustee is a corporation, render the corporation insolvent.

(8) The indemnity may be paid or the insurance purchased from the property to which the personal liability relates and not from any other charitable property.

(9) If the executor, trustee, director or officer is deceased, the indemnity or the proceeds of the insurance may be paid to his or her estate.

COMBINING PROPERTY HELD FOR RESTRICTED OR SPECIAL PURPOSES

3. (1) In this section, contributed property" means, in respect of an individual property, additional property that is added to, and forms part of, a pre-existing individual property.

(2) In the circumstances and subject to the restrictions described in this section, an executor or trustee may combine property received by the executor or trustee for a

restricted or special purpose with other property received by the executor or trustee for another restricted or special purpose and may hold the combined property in one account in a financial institution or invest it as if it were a single property.

(3) The property may be combined only if it advances the administration and management of each of the individual properties to do so.

(4) All gains, losses, income and expenses must be allocated ratably, on a fair and reasonable basis, to the individual properties in accordance with generally accepted accounting principles.

(5) The executor or trustee must maintain the following records for each of the individual properties, in addition to such other records as may be required by law:

1. The value of the individual property immediately before it becomes part of the combined property, and the date on which it becomes part of the combined property.
2. The value of any portion of the individual property that does not become part of the combined property.
3. The source and the value of contributed property relating to an individual property, and the date on which the contributed property is received.
4. The value of the contributed property immediately before it becomes part of the combined property, and the date on which it becomes part of the combined property.
5. The amount of the revenue received by the combined property that is allocated to the individual property, and the date of each allocation.
6. The amount of the expenses paid from the combined property that are allocated to the individual property, and the date of each allocation.
7. The value of all distributions from the combined property made for the purposes of the individual property, and the purpose and date of each distribution.

(6) The executor or trustee must maintain the following records for the combined property, in addition to such other records as may be required by law:

1. The value of each individual property that becomes part of the combined property, and the date on which it becomes part of the combined property.
2. The value of contributed property that becomes part of the combined property, the date on which it be comes part of the combined property, and details of the individual property to which the contributed property relates.
3. The amount of the revenue received by the combined property, the amount allocated to each individual property and the date of each allocation.
4. The amount of the expenses paid from the combined property, the amount allocated to each individual property and the date of each allocation.
5. The value of all distributions from the combined property made for the purposes of an individual property and the purpose and date of each distribution.

4. The Effect of Bill C-6 "Privacy Act" Legislation

BY MERVYN F. WHITE, B.A., L.L.B. AND TERRANCE S. CARTER, B.A., LL.B.

Bill C-6, otherwise known as the *Personal Information Protection and Electronic Documents Act* (the *"Privacy Act")* was passed on April 4th, 2000, and Part I came into effect on January 01, 2001. It is the first privacy legislation dealing with the private sector in Canada. The following is a brief introduction to the legislation, and an illustration of some of the ways that it will impact upon charities.

PURPOSE OF THE PRIVACY ACT

The *Privacy Act* is concerned with the protection of personal information in the context of electronic commerce, as well as the electronic means by which such information is communicated and recorded. There is a myriad of different ways in which personal information is gathered over the internet on a daily basis. Through registration and contest entry forms, when on-line purchases take place, through the use of "cookies" and data mining, and through the use of various software that

can create "pictures" of domain users for their hosts. This brief summary will focus on Part 1 of the *Privacy Act* which has as its stated purpose:

"to establish, in an era in which technology increasingly facilitates the circulation and exchange of information, rules to govern the collection, use and disclosure of personal information in a manner that recognizes the right of privacy of individuals with respect to their personal information for purposes that a reasonable person would consider appropriate in the circumstances."

APPLICABILITY TO CHARITIES

Part 1 will have an obvious effect on charities that engage in fundraising activities on the internet. In order to understand the applicability of this legislation, it is necessary to look at s.4(1) which sets out the scope of Part 1:

s.4(1) *This part applies to every organization in respect of personal information that:*

(i) the organization collects, uses or discloses in the course of commercial activities, or

(ii) is about an employee of the organization and that the organization collects, uses or discloses in connection with the operation of a Federal work, undertaking or business

In order to understand the relevance of s.4(1), some definitions must be understood. First, "Organization" is defined in the Act as including:

> *"…an association, a partnership, a person, a trade union, and both unincorporated and incorporated charities." [emphasis added]*

Secondly, "Commercial Activity" is defined in the *Privacy Act* as:

> *"Any particular transaction, act or conduct or any regular course of conduct that is of a commercial character including the selling, bartering or leasing of donor, membership or other fundraising lists." [emphasis added]*

It should be noted that the Privacy Act will only apply to personal information that is collected, used or disclosed inter-provincially or internationally and will apply to intra-provincial transactions three years after it has come into force. Nevertheless, the reality of the internet is that it is global in scope, so Charities using the internet to solicit fundraising should consider its message as extending beyond the boundaries of the province in which it operates.

It is therefore evident that the *Privacy Act* will apply to Charities that engage in fundraising on the internet. Specifically, it may impact as follows:

(a) Commercial "Conduct":

In the broader sense, Charities may be engaging in "conduct that is of a commercial character" over the internet through fundraising campaigns that include some benefit coming to the donor. For instance, if raffle tickets or tickets to a charity dinner and auction are being sold, or other similar transactions are taking place via the internet, then this could fall within the parameters of commercial conduct. Moreover, when the Charity requests that order forms, etc., are completed on-line, it is 'collecting' and 'using' that personal' information. In this regard, Charities must ensure that they are complying with the legislation in the way that they are collecting, using and disclosing the information.

(b) Donor, Membership or other Fundraising Lists:

The definition of commercial activity in the legislation includes the "selling, bartering or leasing of donor, membership or other fundraising lists." Therefore, the legislation will apply to charities which have acquired lists of names from other organizations for the purpose of contacting those persons as prospective donors. Conversely, the legislation would apply to charities from which other organizations have acquired name lists as well. In this regard, charities that are involved in the acquisition or distribution of name lists must ensure that they are complying with the legislation in the way that the information contained in those lists is collected, used and disclosed.

COMPLYING WITH THE PRIVACY ACT:

For those charities to which the *Privacy Act* applies, there are very strict information control and management provisions that must be complied with. These provisions are adopted from the *National Standard of Canada Model Code for the Protection of Personal Information* (the "CSA Model Code"), which is included as Schedule 1 to the *Privacy Act.* The CSA Model Code is comprised often principles which are briefly set out below:

1. *Accountability:* The organization must be responsible for complying with the CSA Model Code, and must designate an individual or

individuals to be accountable in this regard. The organization must also implement policies to give effect to the CSA Model Code including means of establishing procedures to:

- protect personal information;
- receive and respond to complaints;
- train staff regarding these policies; and
- develop explanatory information regarding these policies.

2. *Identifying Purposes:* The purposes for which information is collected must be identified, documented, and communicated to the individuals whose personal information is being collected either prior to or at the time of its collection. Furthermore, where the information collected is going to be used for a new purpose not originally communicated, the individual whose information is going to be used must be informed of such, and his or her consent must be obtained.

3. *Consent:* The individual whose information an organization wishes to collect, use or disclose must give prior consent of this happening. In addition, the organization must make a reasonable effort to ensure that the individual consents freely. In this regard, the purposes for which and individual's personal information is being collected, used or disclosed must be communicated to the individual in a manner which he or she can reasonably be expected to understand. Furthermore, an organization must not require an individual to consent to the collection, use or disclosure of personal information as a condition of the organization supplying a product or service, except that information that is required to fulfill the explicitly specified and legitimate purposes connected to that product or service. Finally, an individual may withdraw consent at any time subject to legal or contractual restrictions and reasonable notice.

4. *Limiting Collection:* Personal Information must only be collected for necessary and identified purposes, and only by fair and lawful means.

5. *Limiting Use, Disclosure and Retention:* Personal information must only be used for consented to purposes, and may only be retained as long as is necessary to fulfill those purposes.

6. *Accuracy:* Personal information must be routinely kept up to date and accurate.

7. *Safeguards:* Safeguards appropriate to the nature and form of personal information must be implemented.

8. *Openness:* An organization must ensure that its policies and practices for the management of personal information is made readily available.

9. *Individual Access:* Upon request from an individual, the organization must inform that individual of the existence, use and disclosure of his or her personal information and provide access thereto.

10. *Challenging Compliance:* The organization must have a process in place to receive, investigate and address complaints from individuals who wish to challenge the organization's compliance with the CSA Model Code principles.

Consequences of Non-Compliance:

An individual may submit a written complaint to the Privacy Commissioner who may conduct an investigation if there are reasonable grounds. The Privacy Commissioner will submit a report within one year, after which the individual may apply to the court for a hearing. The court may impose various penalties on an organization found to be in contravention of the *Privacy Act*, including:

- ordering an audit of the personal information management practices of the organization;
- publishing information regarding the information management practices of the organization;
- ordering that the organization correct its practices, and publish steps taken by the organization to do so; and
- awarding damages to the Complainant, including damages for humiliation suffered.

It is clear that Bill C-6 will have an impact in the future, and charities should consider the new Privacy Act to determine if it applies to them, and if so, that they are in compliance with it.

5. *The Potential Effects on Charities of Proposed Anti-Terrorism Legislation (Bill C-16)*

BY AARON LEAHY, B.A., LL.B

INTRODUCTION

On March 15, 2001, a new piece of legislation, Bill C-16, received its first reading in Parliament. If passed, Bill C-16, known as the *Charities Registration (Security Information) Act* ("The Act"), would provide an added layer of scrutiny for registered charities and organizations seeking registered charity status. The Act's purported goal is to disallow organizations that directly or indirectly provide support to terrorist activities from attaining or keeping charitable status. The unique feature of the Act is that it allows the Solicitor General and the Minister of National Revenue ("Ministers") to rely upon security or criminal intelligence reports as well as information obtained from foreign sources in considering whether an organization is providing support of terrorist activities. The following is an examination of the Act including a discussion of some of the potential effects that it could have upon charities in Canada.

HOW THE ACT WORKS

Certificate Signed By Ministers:

Under the Act, the Ministers can sign a certificate stating that in their opinion there are reasonable grounds to believe that a registered charity or an organization applying for registered charity status is involved in supporting terrorist activity. The Ministers may rely on security or criminal intelligence reports ("Intelligence Reports"), as well as information obtained in confidence from a foreign based government, institution or agency; or from an institution or agency of an international organization of states ("Foreign Information"). Supporting a terrorist activity could include having directly or indirectly made available resources to an organization or person that was at the time, and continues to be, involved in terrorism or activities in support of terrorism. Such involvement also could include an organization that is making, or that will make, available resources to an organization or person that engages, or will engage in terrorism or activities in support of terrorism.

Certificate Submitted To Federal Court:

Once the Ministers have signed a certificate in respect of an organization, the certificate must be served upon the organization and submitted to the Federal Court. If the Federal Court determines that the certificate is reasonable, the organization named in the certificate will be ineligible to receive charitable status or, if it is a registered charity, will have its charitable status revoked. A certificate deemed by the Federal Court to be reasonable must be published in the *Canada Gazette*. Once a certificate is adopted, it will be effective for a period of three years from the date it is determined to be reasonable.

Evidence Considered By Federal Court:

In considering a certificate, the Federal Court may examine the Intelligence Reports upon which the Ministers based their opinion, and any other relevant information regardless of whether that information would be admissible in a court of law. Upon an application by the Ministers, the court may also consider any Foreign Information if the judge determines it to be relevant.

Reasonable Opportunity To Respond:

The organization which is the subject of a certificate is to be given a reasonable opportunity to be heard by the Federal Court. Prior to that opportunity, the judge is to provide the organization with a summary of the information available to be considered by the judge, except for any information the disclosure of which the judge deems would injure national security or the safety of persons.

Material Change in Circumstances:

Under the Act, the decision of the Federal Court regarding the reasonableness of a certificate is not subject to appeal or judicial review. The only means for an organization to challenge a certificate that has been adopted is to bring an application to the Solicitor General to have the certificate reviewed by the Ministers based on a claim that there has been a material change in the circumstances of the organization. If the Ministers determine that there has been a material change in circumstances, they may decide either to continue or to cancel the certificate. The Ministers' decision in this instance may be appealed to the Federal Court whose decision may not subsequently be appealed. If a certificate that has been found to be reasonable is subsequently cancelled by virtue of a material change in circumstances, notice of that cancellation must be published in the *Canada Gazette*.

COMMENTARY

The following comments regarding the potential effect of the Act may be useful to be considered by charities and organizations wishing to attain charitable status.

Potential Effect Upon Donors:

The version of the Act presented for the first reading in the House of Commons contains the following statement of the purpose of the legislation:

> *The purpose of this Act is to show Canada's commitment to participate in concerted international efforts to deny support to those who engage in terrorism, to protect the integrity of the registration system for charities under the Income Tax Act and to maintain that the confidence of Canadian taxpayers that the benefits of charitable registration are made available only to organizations that operate exclusively for charitable purposes*

The Act is driven by a policy to curb the support of terrorist activities by registered charities. It could be argued that this type of policy could have a positive effect on the public perception of charities. However, the legislation will more likely create an unnecessary and exaggerated sense of alarm in the public which could result in a "chill effect" on donations to any organization that according to the public's perception, and social stereotypes, might be involved in terrorist activities.

Certain Evidence May Not Be Disclosed:

The Act provides that organizations which are the subject of a certificate must be given a reasonable opportunity to be heard. The Act also provides that the organization is to receive a summary of the information available to the Federal Court judge. However, the Act allows the judge to omit from that summary any information the disclosure of which would threaten national security or the safety of persons. This limitation is especially problematic in light of the fact that the Act permits the judge to consider Foreign Information. The fear of some organizations is that those foreign entities that provide information may wish to stifle the efforts of certain charitable organizations for political reasons and therefore may manipulate the information they provide in order to achieve this end. However, if the charitable organizations do not have the ability to know which Foreign Information is being considered in the case against them then they will not have the ability to challenge the credibility of that information through cross-examination. This aspect of the Act seriously hinders a charitable organization's right to be heard and to know the case against it, and therefore raises serious concerns regarding the procedural fairness of the Act.

Issues Regarding the Lack of Appeal or Review:

- **Strict Privative Clause:**

Generally speaking, the spectrum of provisions setting out the parameters of appeal contained within administrative legislation spans the following, starting with the most generous appeal provision:

- A trial *de novo*;
- An appeal on an error of fact or law;
- An appeal based on an error of law only;
- No appeal; or no appeal or judicial review.

The privative clause contained within section 6(2) of the Act, referring to the decision of the Federal Court as to whether the certificate issued by the Ministers is reasonable, states as follows: *"A determination under paragraph (1)(d) is not subject to appeal or review by any court."* This provision falls within the most limited extreme of appeal provisions along the spectrum mentioned above. Considering the serious nature of the allegations being made and rights being affected by the Act, such a strict privative clause would not appear to be justified or warranted in this legislation.

- **Material Change in Circumstances May be Considered:**

The only means for an organization to challenge a certificate that has been adopted is by bringing an application to the Solicitor General to have the certificate reviewed by the Ministers based on a claim that there has been a material change in the circumstances of the organization. The Ministers' decision in this instance is appealable to the Federal Court whose decision is not subsequently appealable. Charities should therefore be aware that absent a material change in circumstances, there is no means by which an organization can appeal a certificate once it has been adopted.

Issues Regarding Lack of Definitions:

- **"Terrorism" and "Terrorist Activity" Not Defined:**

The failure of the Act in its current form to provide a definition of "terrorism" or "terrorist activity" creates considerable concern. The lack of a clear definition creates uncertainty for a charity in knowing whether it is contravening the Act. A clear definition is also made necessary due to the existence of varying beliefs of what

constitutes "terrorism" which are fuelled by divergent political and social ideals within both Canada and foreign countries. Therefore, the absence of a clear definition, especially in light of the reliance upon Foreign Information, is very problematic due to the reality that certain activities that are both legal and charitable in Canada may be considered "terrorist activity" in a foreign country from which Foreign Information being relied upon to investigate a charitable organization may have emanated. For example, the offering of educational services and materials relating to contraception by a Canadian charity involved with planned parenthood may not be welcomed in a foreign country and may be considered "terrorist activity" by some in that country. As another example, religious charities often distribute materials in foreign countries relating to the religious message associated with their charitable purposes. The dissemination of certain religious messages and materials may not be welcomed by the governments of those countries, and in some cases may also be considered "terrorist activity".

As the preceding examples demonstrate, there is a risk that activities which are legal and charitable in Canada may be considered to be "terrorist activity" in a foreign country providing Foreign Information, which further illustrates the need for a clear definition of "terrorism" and "terrorist activity" in the Act. However, if the Act does not contain an inclusive definition of what constitutes "terrorism" and "terrorist activity" then it should at least provide an indication of what the definitions of those terms do *not* include, namely all activities that are legal in Canada.

- **Vague Definition of "Supporting" Terrorism:**

The vagueness regarding the Act's explanation of what constitutes "support" of terrorist activities also raises concerns of substantive fairness. The Act states that supporting a terrorist activity could include having directly or indirectly made available resources to an organization or person that was at the time, and continues to be, involved in terrorism or activities in support of terrorism. Such involvement also could include an organization that is making, or that will make, available resources to an organization or person that engages, or will engage in terrorism or activities in support of terrorism. The breadth and vague nature of this explanation could render it extremely difficult for an organization to determine whether or not it had actually contravened the Act.

Act Does Not Consider Knowledge and Intention:

It is also problematic that the Act does not consider the relevance of the knowledge or intent of a charity in how its support is being used by other organizations. The present wording of the Act would suggest that if one charity provided support to a second charity which itself was involved in supporting terrorism, the first charity would also be at risk under the Act. The Act does not provide for any type of due diligence defence for organizations, nor would it allow organizations such as the first charity in the above example to receive a grace period once it became aware of the actions of the second charity.

Charities also face certain realities that may make it difficult to track the exact usage of the financial aid which they provide, but which are necessarily encountered in providing certain types of charitable relief. For instance, in some countries the only organizations that administer the provision of humanitarian aid, and through which Canadian organizations can channel support for humanitarian aid, may also be indirectly involved in terrorism or the support of terrorist activities. Even if the Canadian organizations were to specify that their support was only to be used for humanitarian aid, and even if the local organizations only used it for such, the fact that the local organizations had a connection to terrorist activities could result in the Canadian organizations being denied charitable status. The Act does not appear to consider how Canadian organizations intend, or direct funds to be used by foreign organizations in this type of scenario. Consequently, this could result in the stifling of humanitarian aid being reached by those countries, as well as raise concerns regarding the substantive fairness of the Act.

Inadequate Confidentiality Provisions:

The risk of creating a negative impact upon the public perception of charities is exacerbated by the fact that the Act does not contain adequate provisions to ensure that the investigation process under the Act remains confidential. The Act requires that a certificate found to be reasonable must be published in the *Canada Gazette*, and that if a certificate is subsequently quashed because of a change in material circumstances, notice thereof must also be published in the *Canada Gazette*. The Act also provides that an organization which is the subject of a certificate may apply to a judge for an order directing that its identity not be published or broadcast except in accordance with the Act, or that any documents filed in court be treated as confidential. However, the Act does not set out the criteria to be considered on such an application to the court, and a decision on an application is not subject to appeal or review by any court. Therefore, the Act does not provide adequate assurance of confidentiality for organizations, which thus fails to recognize the severity of the risk that would exist for an organization's public image to be affected by virtue of it being the considered subject of a certificate, whether or not the certificate is eventually adopted and the organization is barred from having

charitable status. In light of this risk, the disproportionate targeting of certain types of charities for investigation more than others could result in an even greater negative effect upon the public perception of those charities, regardless of the out-come of the investigations involving them.

Issues of Discrimination:

- **Discrimination Against Charities Generally:**

Targeting charitable organizations for investigation regarding connection with terrorist activity more so than other organizations amounts to discrimination against charities. In the absence of clear evidence that charities are involved with terrorism more than other organizations, this discriminatory treatment of charities cannot be justified.

- **Discrimination Against Specific Charities:**

There is a concern that certain charities would be disproportionately targeted for investigation under the Act, amounting in discrimination against those charities. The concern is that stereotypes exist in society that link certain cultural, religious or ethnic organizations with terrorism more than other groups. Therefore, the fear is that those organizations may be targeted for scrutiny under the Act based more so upon those stereotypes rather than being based solely on the availability of greater evidence to implicate them. The Act in its present form also allows for the possibility of an organization to be barred from having charitable registration if it is reasonable to think that it *will* make any of its resources available to an organization or person that *will* engage in terrorism or activities in support of terrorism. This is exactly the type of provision that could be triggered on the basis of these stereotypes, especially in light of the fact that the Act does not limit factors such as reputation connected with culture, race or religion from being considered in determining what types of activities it is reasonable to suspect that an organization *will* be involved in. Absent evidence of a real connection between a charitable organization and involvement in terrorism, singling out a charity based upon the culture, race or religion advanced by that charity's activities would amount in an act of discrimination based solely upon those factors.

CONCLUSION

The goal of eliminating terrorism should be supported through fair and effective legislation. For the reasons outlined above, it is submitted that the proposed Act does not achieve this legislative goal. In targeting charitable organizations, the Act raises issues of discrimination and unfairly prejudices the public perception of charities. The Act also raises issues of procedural and substantive fairness, and carries the potential of unnecessarily stifling legitimate charitable activity. Charitable organizations play an important role in society through their facilitation of services which are both noble and essential. There is considerable government control and regulation of registered charities presently in place which ensures that only those organizations with legitimate charitable purposes and activities may receive status as a registered charity. The effect of the proposed Bill C-16 would be to unfairly and unnecessarily subject charitable organizations to scrutiny of a nature which would have a significant negative impact upon many organizations with legitimate charitable purposes. It is therefore submitted that the proposed Bill C-16 should be replaced by criminal legislation, or at least be significantly amended, but that in its present form it should not be passed into law.

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