

CHURCH & THE LAW UPDATE - No. 9

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Updating Churches on recent legal developments and risk management considerations.

1. INTRODUCTION

This is the ninth issue of *Church & the Law Update*. It is intended to provide an update for churches and charities on current legal developments, as well as providing recommendations on matters of legal risk management where appropriate. The *Church & the Law Update* is prepared as a service to churches and charities and is published approximately three to four times a year as legal developments occur.

This issue of the *Church & the Law Update* provides:

- (i) A summary of the issues to be presented at the 1997 *Church & the Law Seminar*;
- (ii) An explanation of anticipated changes to the Ontario *Charities Accounting Act*;
- (iii) A summary of the warning given by Revenue Canada against issuing tax receipts for indirect payment of tuition fees;
- (iv) An explanation of when a separate corporation for operations in Ontario might be advisable;
- (v) The importance of correctly identifying charities in a will;
- (vi) An update of recent developments involving the Charities Committee of the CBAO; and

2. UPCOMING 1997 CHURCH & THE LAW SEMINAR - February 4th, 1997

The 1997 Annual "*Church & the Law*" Seminar will be held on a new date of Tuesday, February 4th, 1997 in Toronto at Queensway Cathedral in Etobicoke, Ontario. Full details of the program and how to register for the seminar is set out on page 12 of this issue of the CCCC Bulletin. The theme for the seminar is "Avoiding the Fall At Civil Law" and speakers will identify where churches and Christian charities may inadvertently come in conflict with civil law and how such occurrences can be avoided.

As well as having a number of lawyers participate, Professor M.H. Ogilvie, Professor of Law at Carleton University in Ottawa and a member of the Bar of Ontario will be providing an overview on the topic of "The Seven Deadly Myths - What Every Church Administrator Should Know about the Law". Professor Ogilvie is a well respected legal scholar and is the author of an upcoming book on *Religious Institutions and the Law in Canada*.

In addition, George (Chip) Grange, of the law firm of Gammon & Grange in Washington, D.C., will be speaking on the topic of "U.S. Legal Omens on the Horizon - Recent Legal Developments in the United States and Their Impact in Canada". Mr. Grange is one of the leading U.S. Attorneys on charitable law in the United States and is a very effective speaker. All of the speakers, including Ron Knechtel, C.A., will collectively make the 1997 *Church & the Law Seminar* a unique opportunity to hear qualified speakers address legal issues that are directly relevant to churches and Christian charities. All of the speakers have volunteered their time in preparing for and speaking at the Seminar.

3. ANTICIPATED CHANGES TO THE ONTARIO CHARITIES ACCOUNTING ACT

AND WILL PROVIDE RELIEF TO CHARITIES

By: Terrance S. Carter, B.A., LL.B.

Readers will recall from the *Church & the Law* Update No. 8 (June 20th, 1996) that major changes are being made by the Ontario Provincial Government to the *Charities Accounting Act* through the recent adoption of Bill 79 and the pending adoption of Bill 61 that will together significantly expand the jurisdiction of the Public Guardian and Trustee ("PGT") to permit it, amongst other matters, to regulate and provide relief for charities and their boards of directors in dealing with the common law rule prohibiting conflicts of interest for directors of charities. The Ministry of the Attorney General describes the changes as permitting charities to be administered according to modern business-like practices and to keep minor technical matters out of the court.

Background: To understand what has led to the amendments to the *Charities Accounting Act*, it is necessary to briefly review developments in case law that have occurred in recent years dealing with charities and their boards of directors.

Charities that operate in Ontario are subject to the jurisdiction of the Public Guardian and Trustee of Ontario (formerly the Public Trustee) pursuant to the provisions of the *Charities Accounting Act* and other provincial legislation, such as the *Charitable Gifts Act*. The PGT in exercising its "watch dog role" over charities in Ontario during the past ten years has been successful through a number of cases in confirming that the fiduciary role for members of a board of directors or other controlling board of a charity places a trustee-like obligation upon directors that prohibits them from receiving either directly or indirectly any remuneration from the charity without first obtaining court approval. (see the lead case of *Re: Toronto Human Society (1987)*, 60 O.R. (236). See also *Re: The David Feldman Charitable Foundation, (1987)*, 58 O.R. (66), *Re: Faith Haven Bible Training Centre (1988)*, 29 E.T.R. (198), and *Re: Harold G. Fox Education Fund v. Public Trustee (1989)*, 69 O.R. (742).)

From a practical standpoint, the legal principles established in these cases means that an employee of a charity, no matter how large the charity or how senior the employee, cannot serve on its board of directors without court approval. It also means that board members who are asked to provide paid services to the charity, often at a reduced fee, such as those provided by lawyers, accountants, insurance agents, or real estate agents, have to either resign from the board of the charity or alternatively have to obtain court approval before they can receive payment. As result, many charities have had to restructure their general operating by-laws so that key individuals, such as executive directors or ministers who are no longer able to remain on the controlling board, have been given enhanced authority as officers of the charity to permit them to be present and participate at board meetings without being put into a conflict of interest by being a member of the board of directors.

Many other charities, though, have ignored the law in this regard at their peril, either through lack of knowledge or wishful thinking that the law will somehow not effect them. In addition, some charities operating in Ontario that have been incorporated either federally or in other provinces have incorrectly assumed that the Ontario case law does not have application to them. If such charities raise monies in Ontario, it is the position of the PGT that in doing so, the directors of those charities become subject to the law in Ontario in relation to those monies.

While the prohibition of directors receiving remuneration is well founded at common law, the practical consequences of the rule have caused some difficulties for many charities that have directors who often find themselves in a conflict of interest. Extensions of this rule by the PGT in the past year to what was considered to be standard activities involving directors has become a major source of concern for charities in Ontario. This became evident when the PGT took the position earlier this year that a charity was unable to use charitable funds to purchase directors and officers insurance for its board members without first obtaining court approval. Their position was that the acquisition of directors and officers insurance constituted an indirect benefit to the directors. This same position was taken in relation to the inability of a charity to adopt an indemnification by-law for directors and officers without first obtaining court approval.

Although the correctness of this interpretation of the law is debateable (see comments by the author in the March 1996 Law Society Special Lectures on "Advising the Charitable Client"), the fact remains that all charities in Ontario that would like to obtain directors and officers liability insurance or adopt an indemnification by-law have been put in the untenable position of either having to obtain court approval or risk being found in breach of trust if they fail to do so. As a result, in June of this year, the Attorney General's Office in conjunction with the PGT introduced remedial amendments to the *Charities Accounting Act* through Bills 61 and 79 to provide relief for some of these harsher applications of the common law principles. Bill 79 has received Royal Assent and was proclaimed in force on October 31, 1996. Bill 61 received first reading on June 13, 1996 and is expected to proceed to third reading and proclamation in the near future.

Bill 79 - Relief By Regulation: Bill 79 amends the *Charities Accounting Act* by allowing the Attorney General's Office to adopt regulations dealing with charities on the advice of the PGT instead of going through the Lieutenant Governor in Council. The scope for the regulations

that can be made include dealing with acts or omissions that would otherwise require the approval of the courts in the exercise of their inherent jurisdiction in charitable matters, which once adopted would be treated as though the acts or omissions have been approved by the courts. Regulations are specifically limited to the following matters:

- (a) Regulations can be made setting out which benefits may be given to directors or trustees of a charity. From a practical standpoint, the PGT and the Attorney General have advised that forthcoming regulations will likely set out guidelines by which charities can purchase directors and officers liability insurance and adopt indemnification by-laws. It is also expected that regulations will permit situations where it is determined advisable to have an employee on the board of a charity, such as an employee representative for a large charity.
- (b) Regulations can be made dealing with administration or management of special purpose and restricted charitable funds.
- (c) In addition, regulations can be made concerning the retention and destruction of records by charitable organizations of trustees.

The regulations that are made will not apply to any act or omission that conflicts with the will or instruments creating the charitable trust fund. In addition, regulations may either be general or particular in their application and may be limited to the persons, classes of persons, or circumstances as set out in the regulations. The determination of exactly what will be included in the regulations will be subject to review by a Committee appointed by the Attorney General's Office made up of representatives from the charitable sector, as well as representatives from both the legal and accounting professions.

The overall effect of the regulations will provide a mechanism to provide more certainty and avoid unnecessary complications in dealing with charitable matters that would otherwise require expensive and unnecessary court approval, such as obtaining directors and officers liability insurance.

Court Approval By Consent: For those matters that require approval but are not dealt with by regulation under Bill 79, the amendments to the *Charitable Accounting Act* contained in Bill 61 propose a simplified approval process to obtain the necessary court approval. Bill 61 proposes that a draft order or judgement that could have been made by the Ontario Court (General Division) under the *Charities Accounting Act*, or under any other Provincial legislation dealing with charitable matters, or in the exercise of the inherent jurisdiction of the court in charitable matters, is deemed to be an order or judgement of that court if the PGT and any of the persons who would have been required to be served in the proceedings to obtain the judgement gives written consent to the draft order or judgement.

A similar type of simplified procedure was first contemplated in *Re: Toronto Human Society* where the court suggested that the requisite court approval could be obtained by "*fiat*" from the Public Trustee. At that time, there was no statutory authority to do so. Now there will be. As a result, charities that are either incorporated in Ontario, or operate in Ontario, or even do fundraising in Ontario, will be able to deal with both substantive and technical court applications that are not covered by the regulations in an expeditious and efficient manner that otherwise would have had to be dealt with through a formal court application process.

In addition, the consent order process will also simplify *cy- près* court applications that may need to be brought from time to time to determine the proper application of charitable funds if the terms of the charitable gift in a will can no longer be complied with.

Implications Of Amendments: Although the amendments to the *Charities Accounting Act* set out in Bills 61 (once it is passed) and Bill 79 (which has been proclaimed) constitute a welcome relief from some of the harsher applications of the recent court decisions in Ontario over the last ten years, there are at the same time some serious implications that will need to be addressed. A few of these implications are summarized as follows:

- (a) For those charities that either by design or default fail to comply with the common law rule prohibiting remuneration of directors beyond what is permitted by regulations under the *Charities Accounting Act*, or alternatively do not apply for the specific relief by a consent order in conjunction with the PGT, it is possible that they will be dealt with more stringently by the PGT and/or the courts if a matter of a conflict of interest comes under judicial scrutiny. As such, the relieving provisions of Bill 61 and Bill 79 to the *Charities Accounting Act* constitutes a two edge sword for charities. Charities and their boards must either comply with the law as modified by the regulations in Bill 79 or run a greater risk of being found in breach of trust.
- (b) For those matters that are currently before the courts, the amendments to the *Charities Accounting Act* proposed in Bill 61 will permit those issues to be resolved with the consent of the PGT and all interested parties without having to obtain final court approval. Similarly, if a matter that is intended to proceed on a consent basis is not able to be completed as a result of a disagreement, the charity can still have the matter proceed to court at any time notwithstanding the initial application to have the matter dealt with on a consent basis.
- (c) The significant increase in the power of the PGT that results from the amendments not only constitutes the first significant expansion of authority given to that office since the *Charities Accounting Act* was first proclaimed in 1915, but in effect elevates the PGT into a

quasi-judicial body parallel in some ways to the Charity Commission in England. While the Charities Division of the PGT is presently well administered under the oversight of the Director of Charities, Mr. Eric Moore, there has been a considerable increase in the power and jurisdiction that has been given to an administrative body of the government. Possibly this is an appropriate time to consider the formation of a Charities Commission for Canada that would be able to deal with all aspects of charities in this country, including matters of income tax, trust law affecting charities, as well as collateral issues such as G.S.T.

In the meantime, the recent changes that have been made in Bill 79 and are proposed in Bill 61 to the *Charities Accounting Act* will provide much needed short term relief from overly technical applications of law dealing with charities so that the affected charities will be able to concentrate upon fulfilling their charitable objectives instead of having to expend time and monies on unnecessarily expensive legal proceedings. In this regard, the amendments to the *Charities Accounting Act*, although not without faults, are a welcome initiative in encouraging and facilitating the charitable sector in Ontario. Now that Bill 79 has been proclaimed, hopefully Bill 61 will also receive speedy approval in the completion of this worthwhile initiative.

More details concerning the specifics and implications of Bill 61 and 79 of the *Charities Accounting Act* will be presented at the upcoming 1997 *Church & the Law* Seminar on February 4th, 1997.

4. REVENUE CANADA NEWSLETTER TAKES POSITION ON TAX RECEIPTS FOR TUITION FEES

By: Terrance S. Carter, B.A., LL.B.

The Summer 1996 Registered Charities Newsletter - No. 6 issued by Revenue Canada was forwarded to all registered charities in Canada. It warned that funds contributed (either directly or through the use of a "charitable gift coupon" issued by a separate registered charity) to pay tuition fees for the donor's child at a private school that is a registered charity would not be a "legally defined" gift.

The newsletter states that Revenue Canada will not allow any portion of a tuition fee to be treated as a legally defined gift unless the tuition fee is paid directly to a religious school and a portion of the payment qualifies as a gift under Information Circular 75-23 as it relates to religious education.

In the newsletter Revenue Canada also takes the position that gifts by parents to a student aid fund administered by a registered charity are not legally defined gifts where their child or children receive financial assistance from such fund.

The newsletter concludes with a warning that "charities involved in these types of programs can lose their status as registered charities" and donors who use receipts issued for such contributions may find that a part or all of their claim will be disallowed by Revenue Canada. There is a legal challenge to Revenue Canada's position which will be heard within four months. The outcome of the challenge is obviously unknown at this time. Pending the outcome, any individual or charity who is involved in such a program should seek counsel concerning their response to the position and warning given by Revenue Canada.

5. POSSIBLE USE OF SEPARATE CORPORATION FOR ONTARIO OPERATIONS

By: Terrance S. Carter, B.A., LL.B.

Most charities incorporated outside of Ontario carry on some form of operation in Ontario, whether it be by opening an Ontario regional office, or simply raising support from donors in that province. Although there is nothing to preclude a charity that is incorporated outside of Ontario (either through provincial or federal incorporation) from operating as an extra-provincial corporation in Ontario, by doing so, it will become subject to the more stringent jurisdiction of the Public Guardian and Trustees Office ("PGT") under the *Charities Accounting Act* and the *Charitable Gifts Act* in relation to the monies that are raised in Ontario.

In addition, the investment restrictions of the *Trustee Act* of Ontario will have application, unless the letters patent of the extra-provincial corporation give broader investment powers than of those provided under Ontario Statute Law.

If the Public Guardian and Trustees Office was, for whatever reason, to intervene in the operations of a charity incorporated outside of Ontario, all aspects of its operations may become subject to scrutiny by the PGT, since it may be impossible from a practical context to segregate the Ontario operations from those in the rest of Canada.

In this regard, whenever concern is raised about the administration or management of a charity, for whatever reason, the PGT can require the charity to pass its account in court. If it is found that the charity has misapplied or misappropriated funds from the purposes contained in the letters patent of the charity, the PGT can apply for an order appointing their office as trustee over the charity. Although seldom done, such extreme action by the PGT could warrant legal proceedings being brought against the directors of the charity.

In addition, the PGT may require court approval to authorize past activities of the charity that were conducted outside of the corporate objects of the charity, i.e., activities that were *ultra vires* the corporate capacity of the charity. As indicated earlier in this issue of the *Church & the Law Update*, there are currently amendments to the *Charities Accounting Act* pending before the provincial legislature that will make the procedure to obtain a consent order in this regard much easier. However, this new procedure now underscores the fact that the PGT will expect more than ever that charities operating in Ontario will need to ensure that their operations comply with their charitable objects, failing which there may be a more stringent position taken by the PGT concerning breach of trust by the directors of the charity in operating the corporation outside of its charitable objects.

In addition to the initiatives available to the PGT's Office, Section 6 of *Charities Accounting Act* of Ontario provides that any person may complain concerning the manner in which an organization has solicited funds and the manner in which those funds are dealt with. The application can be made on an *ex-parte* basis to a judge in Ontario. Where the judge is of the opinion that the public interest can be served by an investigation of the matter, the judge may make an order directing the PGT to conduct a public inquiry under the *Public Inquiries Act* upon receiving the report of the PGT's Office. The judge may then order a judicial passing of accounts under Section 23 of the *Trustee Act* of Ontario.

There have been only two reported cases involving an *ex-parte* order under Section 6 of the *Charities Accounting Act*. The most recent of which involved the Hamilton Naturalist Club in October of 1995 which arose when a disgruntle individual became upset with the charity because its board of directors refused to publish a pamphlet that the individual had written concerning a small creek in the area. The application was successful and the matter is still being dealt with by the PGT's Office as a public inquiry. This type of court proceeding is clearly an effective tool for individuals and organizations to use who are intent upon aggressively attacking the fundraising operations of a charity in Ontario or its use of the funds raised.

Although Section 6(8) of the *Charities Accounting Act* states that an *ex-parte* order does not apply to a "religious or fraternal organization or to any person who solicited or procured any funds of any religious or fraternal organization", there does not appear to be any case law defining what "religious organization" means. It may be that many para-church organizations have objects that are not restrictive enough to strictly constitute a "religious organization" under the *Charities Accounting Act* if their objects were judicially reviewed. As such, it is possible that a member of the public might be successful in obtaining an *ex-parte* order under Section 6 of the *Charities Accounting Act* in relation to a para-church organization concerning its soliciting of funds in Ontario or its application of those funds. This could prove problematic in the event of a special interest group deciding to actively oppose the work of a para-church organization, particularly one that was taking an active position on social issues in Ontario. Such group might bring a court application based upon a request for a determination concerning whether the position taken by the charity on social issues in Ontario was within the permitted parameters of its charitable objects.

In consideration of the unique jurisdiction of the PGT and the courts over charities operating in Ontario, there might be merit for some national charities to consider establishing a separate charitable corporation to carry on its operations in Ontario. This option is obviously not for every charity, nor is without logistical problems, since there would be two charities operating in Canada, thereby increasing the risk of confusion in future donations and estate gifts.

However, the benefits that would emanate from operating a separate charity in Ontario can be summarized as follows:

- (a) The jurisdiction of the PGT would be limited to the operations of the Ontario charity instead of extending to the activities of the national charity operating throughout the rest of Canada.
- (b) Any liability exposure that would be associated with the charity taking an activist role on social issues in Ontario would be contained within the Ontario corporation instead of exposing the assets of the national charity. In this way, a separate Ontario corporation would be an indirect way of accomplishing one of the key objects associated with operating a parallel foundation, i.e., that of protecting ministry assets.
- (c) The possibility of a disgruntle member of the public obtaining an *ex-parte* order for a public inquiry would be limited to the operations of the Ontario charity instead of extending to the national charity.
- (d) The possibility of complaints and inquiries arising out of violation of the *Ontario Human Rights Code* would be limited to Ontario operations as opposed to national operations.
- (e) Any exposure of director and officer liability arising from Ontario statutes, such as the *Occupational Health and Safety Act*, or under common law would be limited to the board of directors of the Ontario charity, instead of extending to the board of directors of the national charity operating in the rest of Canada. The exposure to liability for the Ontario charity could also be reduced by keeping the number of directors to a minimum by using committees and an advisory board instead of exposing a larger number of individuals to the possibility of director and officer liability.

If a separate corporation for Ontario was established, then the name should be geographically distinctive, such as "ABC Ministries (Ontario)". All donors in Ontario would be advised to direct their gifts specifically to the Ontario charity. In addition, all literature distributed to supporters in Ontario would need to indicate that any gifts from residents in Ontario made out in a name other than the specific name of the national charity, i.e., "ABC Ministry", would be deemed to be a gift to "ABC Ministry (Ontario)".

Any difficulties involved in transferring monies from the Ontario charity to the national charity under the *Income Tax Act* (i.e., that no more than 50% of receipted income being able to be transferred to the charity) could be dealt with by obtaining Associate Charity Status for the two organizations to allow a free flow of monies, or possibly structuring the charity for Ontario as a public foundation. Effective control of the separate charity in Ontario could be dealt with by requiring written approval of the board of directors for the national charity for anyone to qualify or continue as either a member of the board of directors or as a corporate members of the Ontario charity.

If a separate charity for Ontario was established, then the application for incorporation could be done under Part II of the *Canada Corporations Act* in consideration of the speed in processing the application at a federal level, as well as the ability to avoid the approval process of the PGT that is otherwise required for the incorporation of a non-share capital corporation done pursuant to Part II of the *Corporations Act* of Ontario.

The possible establishment of a separate corporation for an Ontario operation involves a detailed review of many complex issues and may not be appropriate for every national charity. As a result, the circumstances of each charity must be reviewed with legal counsel before pursuing the matter further.

6. UPDATE ON CBAO CHARITIES COMMITTEE

As indicated in the *Church & the Law* Update No. 8, the Canadian Bar Association of Ontario ("CBAO") Charities Committee was reactivated in April of 1996 with regular meetings being held on September 20th and November 26th, 1996. The Committee was formed as a result of the growing interest of lawyers in Ontario who deal with charities on both a frequent and infrequent basis to become more conversant in the legal issues involving charities. The terms of reference of the Charities Committee include the following:

- a forum to discuss current issues in the law involving charities through regular meetings and a newsletter
- making submissions to government bodies on legal issues involving charities
- co-ordinating legal education concerning charities
- acting as a liaison with other bodies involved in acting for charities

At the September 20, 1996 meeting, sub-committees were formed to deal with proposed changes to the *Charities Accounting Act* under *Bill 61* and *79*, as well as proposed changes to the *Canada Corporations Act* and the *Ontario Corporations Act*. In addition, a sub-committee was formed to study the possibility of forming a Canadian Charities Commission modeled on the Charities Commission in England.

The CBAO Charities Committee is intending to apply for Section status within the CBAO and would like to see the Ontario Section expanded to become a national Section. In this regard, lawyers in other Provinces are welcome to join the CBAO Charities Committee pending a national Section being established. For more information, lawyers in Ontario as well as any other Province should contact the CBAO co-ordinator Janice Richardson, at 1-800-668-8900 or 416-869-1047, Terrance S. Carter, co-chair of the committee at 519-941-1760, Jane Burke-Robertson, vice-chair, at 613-233-2675, or John Hamilton, co-chair, at 416-947-5015.

7. LIABILITY CLAIM FOR SEXUAL ABUSE WIPES OUT CHARITABLE ASSETS

By: Terrance S. Carter, B.A., LL.B.

The *Globe and Mail* on October 30th, 1996 carried an article explaining the consequences of what happens when large claims of sexual abuse arise and a charity has limited assets to meet those claims. The Christian Brothers of Ireland, who ran the Mount Cashel Orphanage in Newfoundland, have holdings of only 4.3 million dollars in Canada. However, claims totalling more than 35 million have been made against the Christian Brothers. As a result, the lay order announced that it would have to sell its Canadian holdings to compensate those who were sexually and physically abused.

The spokesperson for the lay order is quoted as saying "whatever our assets are, we are giving them over to the court for sale by a

liquidator". The decision by the Christian Brothers came after negotiations stalled with the abused men. The Globe and Mail reports that nine members of the lay order have been convicted of abusing boys in their care and several more charges have been laid.

The example of what is happening to the assets of the Christian Brothers is a warning to all churches and Christian charities in Canada that face actual or possible claims for sexual abuse. If there is not sufficient insurance coverage, then a successful claim may require the church or charity to liquidate its assets to satisfy future claims. This is a sobering warning concerning the consequences of claims arising out of sexual abuse.

To decrease incidents of sexual abuse, all churches and Christian charities should adopt a comprehensive sexual abuse policy to avoid sexual or physical injury to children, including a mandatory criminal record check. Church and charities should speak with their legal counsel concerning this matter if they do not have a sexual abuse policy statement in place.

DISCLAIMER: This *Church & the Law Update* is a summary of current legal issues provided as an information service. It is current only as of the date of the Update and does not reflect changes in the law that have occurred subsequent to the date of the Update. The Church & the Law Update is distributed with the understanding that it does not constitute legal advice or establish the solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision making. Readers are advised to consult with a qualified lawyer and obtain written opinion concerning the specifics of their particular situation.

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