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# SPRING 2018 – CARTERS CHARITY & NFP WEBINAR SERIES

May 30, 2018

## REMUNERATION OF DIRECTORS OF CHARITIES: WHAT'S NEW?

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## A. INTRODUCTION

- Amendments to [Ontario Regulation 4/01](#) (the “Regulation”) to the *Charities Accounting Act* (the “CAA”) came into force on April 1, 2018 (the “Amendments”)
- The Amendments amend the Regulation to provide relief from the common law rule prohibiting the remuneration of directors of charitable corporations and persons related to them by outlining certain circumstances where charitable corporations would be authorized to pay directors and related persons for goods, services, or facilities

## B. OVERVIEW OF TOPICS

- Who benefits from the Amendments?
- What is the current common law prohibition on director remuneration and statutory law in Ontario?
  - Fiduciary duties of directors of charitable corporations
  - But what about the corporate law?
  - We’re a registered charity; do other rules apply?
- What’s new in the Amendments?
- Comments on the Office of the Public Guardian and Trustee’s (“PGT”) guidance, “[Payments to Directors & Connected Persons](#)”

## C. WHO WILL BENEFIT FROM THE AMENDMENTS?

- The Amendments apply to a “corporate trustee”, which is defined as “a corporation deemed by subsection 1(2) of the CAA to be a trustee within the meaning of the Act”
  - The CAA deems all corporations incorporated for “a religious, educational, charitable or public purpose” to be trustees within the meaning of the CAA
- Therefore, the Amendments are intended for directors of charitable corporations, e.g., those incorporated under the *Corporations Act* (Ontario) or the future *Not-for-profit Corporations Act* (Ontario)

- In the view of the PGT, the common law in Ontario and CAA also apply to federally incorporated charitable corporations, e.g., *Canada Not-for-profit Corporations Act* charities
  - Province has proper jurisdiction over charities
  - PGT’s guidance “[Payments to Directors & Connected Persons](#)” (the “Guidance”) confirms that the Regulation has application to charitable corporations “operating” in Ontario
- The Amendments do not apply to charities operating as unincorporated charities or trusts
  - The common law prohibition may be relaxed with respect to trusts since the settlor in making the trust document can provide for payments for certain services rendered by trustees

- Also the Regulation not impact other exceptions to the common law
  - e.g., Regulations under the *Public Hospitals Act* (Ontario) specifically provide that certain paid staff of a hospital are to sit on its board of directors, such as the administrator of the hospital, and the chief of staff of the hospital
- The Regulation does not permit payments that are prohibited by the charitable corporation’s governing documents or by any other legislation applicable to the corporation, or any rules of professional conduct applicable to the director
  - e.g., section 95(1) of the *Corporations Act* (Ontario) does not permit a director to act as an “auditor”

## D. WHAT IS THE CURRENT LAW IN ONTARIO?

### 1. Fiduciary duties of directors of charities

- The PGT in it’s guidance “[Duties, Responsibilities, and Powers of Directors and Trustees of Charities](#)” states:

*“Generally a charity cannot pay a director to act in the capacity of a director. Also, a director cannot be paid for services provided in any other capacity unless permitted by a court order. In appropriate circumstances, payment for services other than as a director may be allowed by Court Order or by an Order made under section 13 of the Charities Accounting Act where it is in the charity’s best interest to do so*

*A trustee also cannot be paid for services in any capacity unless approved in advance either by the court or by an order made under section 13 of the Charities Accounting Act. A trustee may also be paid when authorized by the document which creates the trust. The document that creates the trust can also prohibit or restrict payment to trustees. A charity can reimburse a director or trustee for reasonable expenses”*

- This position is based upon a series of cases in Ontario which established at common law that directors of charities are considered to have high fiduciary obligations in respect of charitable property
  - As a result, it is a conflict of interest and a breach of trust for a charity to pay any monies of the charity to any director as remuneration for any services rendered by the director to the charity, directly or indirectly, whether it is in his/her capacity as a director or for other services provided to the charity
  - Applies to those not at arm's-length from the director
- Whether the director is a voting director or non-voting one is irrelevant

- How were directors of charitable corporations in Ontario able to receive remuneration directly or indirectly before the Amendments?
  - Option #1: Resign!
  - Option #2: Obtain prior court approval
    - In Ontario, the PGT is able to exercise the authority of the courts in a limited context by granting consent orders made under section 13 of the CAA
- What if directors received remuneration from a charitable corporation without a court order or under the Regulation?
  - Directors may be personally liable for any payments received and may have to repay the charity

- Applicants for a section 13 order are reviewed on a case by case basis, but must generally be able to show:
  - Remunerating the directors for their services in another capacity would be in the best interests of the charitable corporation
    - Factors that might be considered include: the directors are providing their services at below market costs; the directors have niche expertise that is not generally available commercially; the charity took steps to obtain quotes from other third-parties and explored other alternatives
  - Also prudent to establish process to minimize any conflict of interest resulting from the payments

## 2. What about the corporate law?

- Many corporate statutes that apply to non-profit corporations often permit directors to be remunerated
  - *Canada Not-for-profit Corporations Act* (s. 143) and the new *Not-for-Profit Corporations Act, 2010* (Ontario) (s. 47), specifically provide that the board may fix the reasonable remuneration of the directors and allows directors to receive reasonable remuneration for services to the corporation performed in another capacity
  - Existing *Corporations Act* (Ontario) permits directors to pass by-law concerning “the qualification of and the remuneration of” directors (para. 129(1)(f))
  - See also statutory conflict of interest provisions

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- In Ontario, the common law overrides these provisions
- For Ontario corporate statutes, clarification in this regard was included in Bill 154, the *Cutting Unnecessary Red Tape Act, 2017*:
  - “If a provision in this Act or in a regulation made under it that applies to a corporation, the objects of which are exclusively for charitable purposes, conflicts with a law relating to charities, the law relating to charities prevails, regardless of whether it is a provision in another Act or regulation or a rule or principle of common law or equity.”
    - New ss.117.1(2) and ss. 5(2) respectively

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### 3. We're a registered charity; do other rules apply?

- Registered charities also need to be aware of compliance with the *Income Tax Act (Canada)*
- The Guidance confirms that directors should review applicable requirements of the *Income Tax Act (Canada)*
- See CRA Summary Policy [CSP-D10](#) concerning Directors/Trustees
  - Payments to directors are subject to law of charities in provinces
- However, various penalties or suspensions under the *Income Tax Act (Canada)* could apply

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- Registered charities cannot provide any “undue benefit” to its directors or other related individuals
  - i.e., a gift or “any part of the income, rights, property or resources of the charity” for the personal benefit of any person who is a “proprietor, member, shareholder, trustee, or settlor of the charity”, who contributed more than 50 per cent of the capital of the charity or does not deal at arm’s length with the charity
  - “undue benefit” excludes “an amount that is reasonable consideration or remuneration for ... services rendered to the charity or association”
- CRA can assess a penalty of 105% of any undue benefit conferred; 110% if assessed again within a 5 year period, or suspension of receipting privileges

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- Failing to meet the definition of a registered charity
  - Subsection 149.1(1) of the *Income Tax Act* (Canada) requires that a “charitable organization” devote all of its resources to “charitable activities carried on by the organization itself”
  - As well, a “charitable foundation” is required to be “operated exclusively for charitable purposes”.
  - As a consequence, if a registered charity provides unreasonable compensation or other indirect benefits to directors, CRA may conclude that the charity is not operating for exclusively charitable purposes, i.e., having a “collateral unstated purpose”
  - CRA may revoke the registration of a registered charity that has a collateral unstated purposes

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- Unreasonable compensation or other director or indirect benefit to a director may also be a “private benefit”
  - i.e., any benefit provided to a person or organization that is not a charitable beneficiary, or a benefit to a charitable beneficiary that exceeds the bounds of what CRA considers “charity” to be at common law
  - Generally, a private benefit occurs when a charity’s resources promote the interests of individuals involved in private business or of a non-qualified donee, unless the private benefit is incidental, meaning it is necessary, reasonable, and not disproportionate to the resulting public benefit

## E. WHAT’S NEW IN THE AMENDMENTS?

- Amendments would permit a charitable corporation to make payments to:
  - A director of a charitable corporation; and
  - A “person connected” to a director of the charitable corporation
- Who is a “person connected”?
  - Amendments defines the following as “persons connected”
    - A spouse, child, parent, grandparent or sibling of the director
    - employer of the director or of a spouse, child, parent, grandparent or sibling of the director

- A corporation in certain circumstances, e.g., ownership of more than 5% of shares by the director or spouse, child, parent, grandparent or sibling of the director, ownership of 20% of the voting shares, or where the person acts as a director or officer
- A partnership in which the director or spouse, child, parent, grandparent or sibling of the director is a director, or in which a corporation that is connected to the director is a partner
- A partner in a partnership in which the director or spouse, child, parent, grandparent or sibling of the director is a director, or in which a corporation that is connected to the director is a partner

- Under the Amendments, directors continue to be prohibited from receiving direct or indirect payment for services they provide:
  - in their capacity as directors or employees of the charitable corporation;
  - for fundraising services; and
  - for selling goods or services for fundraising, or in connection to the purchase or sale of real property.
- Therefore, it is still not permissible for a director to receive remuneration in his or her capacity as a board member, or as an employee of the charitable corporation

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- Before payments can be made to a corporate director or a “person connected”, the charitable corporation would first need to meet a number of conditions set out in the Amendments
  - The payment must be made with a view to the charity's best interests
  - The payment must be in an amount that is reasonable for the goods, services or facilities provided
  - The payment must not result in the amount of the debts and liabilities of the charity exceeding the value of the charity or render the corporation insolvent

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- Before the board may authorize the payment:
  - Every director must agree in writing to the maximum amount that can be paid for the goods, services or facilities
  - Every director, other than the director receiving the payment, must agree in writing that that they are satisfied that the conditions set out in the regulation have been met
  - The board must consider any guidance issued by the Public Guardian and Trustee, i.e., the Guidance
- There must be at least four directors on the board, not including the conflicted director, i.e., 5
- The director who receives the payment, or “person connected”, do not attend the meeting to authorize the payment or vote

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- The number of directors receiving remuneration, or who are connected to persons receiving remuneration, cannot be greater than 20% of the total number of directors in any fiscal year
- The payment to the director must be reported at the annual general meeting and must be noted on the charity's financial statements
- In addition, payments made to a not-for-profit corporation or a corporation wholly owned by the charity, would be exempt from the regulation if no director of charitable corporation or “person connected” receives a benefit
  - e.g., payments to a wholly owned subsidiary if no benefit was received by the charity's directors or persons connected to them

## F. COMMENTS ON THE PGT'S GUIDANCE

- Included in the amendments to the Regulation is a requirement under s. 2.1(6)(c) for charitable corporations to consider any guidance respecting payments when approving such payments to directors or connected persons
- The PGT published its Guidance in late May
- Guidance is set out as 19 sections that elaborate upon s. 2.1 of the Regulation in a “frequently asked questions” format, with most sections answering a specific question and clarifying certain sections of the Regulation

- Conditions for Authorizing Payments
  - The Guidance outlines the conditions required under ss. 2.1(5) - (7) for remuneration to be authorized and elaborates upon the requirements.
  - The Guidance provides five factors for the board to consider prior to authorizing a payment including, for example, the experience and qualifications of the director or connected person, and any adverse impacts on the charitable corporation.

- In considering whether an authorized amount is reasonable, the Guidance provides a list of factors
  - e.g., the market price for similar goods, services or facilities and the quality of them.
  - Where the cost of a service is large and the charitable corporation does not have information on market prices, they may obtain quotes from suppliers.
- As the payment increases, so does the burden on charitable corporations to demonstrate that they considered the market price

- Record Keeping and Ancillary Requirements
  - The Guidance states that charitable corporations should keep records of everything related to compliance with the Regulation, including, for example:
    - a copy of the agreement and approvals;
    - documenting the decision-making process, including market research, supplier quotes;
    - documenting the fact that the board reviewed the Guidance, and the rationale for the decision
  - The Guidance states that complaints about alleged improper payments can be answered where the charitable corporation is able to show, through good recordkeeping, that it complied with the Regulation

- Regulation requires authorized payments that have been made to be disclosed to the charitable corporation's members at its annual members meeting and in its financial statements
  - Guidance states that disclosure should "meet relevant accounting practices"
  - Outlines the PGT's guidelines for disclosure within financial statements which, among other things, require the information to be placed in the financial statement's notes, the director in question to be named, and the nature of the transaction to be mentioned in broad terms

## G. CONCLUSION

- The Amendments ease the process for incorporated charities that want to rely upon their board members who can provide services in another capacity without the need for a consent order
- Process to obtain a section 13 consent order under the CAA can be time intensive and generally requires the assistance of legal counsel; amendments and thorough Guidance are welcome exception

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