

INELIGIBLE INDIVIDUALS - NEW GOVERNANCE PROVISIONS FOR CHARITIES

*By Karen J. Cooper**

A. INTRODUCTION

The 2011 Federal Budget, which passed in the House of Commons on November 21, 2011 and received second reading in the senate on November 24, 2011,¹ contained several controversial provisions that have received a great deal of attention from the legal community and the general public. However, the Budget also included several less noticeable provisions that will be of great significance to the charitable sector. These provisions, entitled “Strengthening the Charitable Sector”, introduced a number of changes to the regulatory regime affecting registered charities. One of the most significant of these changes is the introduction of provisions rendering certain individuals ineligible to serve on the board of or in a senior capacity within a registered charity.

The “ineligible individual” provisions came as a result of concerns from the Canada Revenue Agency (CRA) that applications for charitable status were being submitted by individuals who had previously been involved with charities that had their charitable status revoked for serious non-compliance. The department of Finance is proposing to introduce the concept of “ineligible individuals” to the *Income Tax Act* (“ITA”), which will enable CRA to withhold or revoke charitable status of organizations that have ineligible individuals on the

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¹ Bill C-13, *Keeping Canada’s Economy and Jobs Growing Act*, 1st Sess, 41st Parliament, 2011, available at <http://www.parl.gc.ca/HousePublications/Publication.aspx?Docid=5155334&file=4>.

board or serving as a senior manager, in order to better safeguard charitable assets.² The full budget plan can be accessed here: <http://www.budget.gc.ca/2011/plan/Budget2011-eng.pdf>.

B. THE “INELIGIBLE INDIVIDUAL” PROVISIONS

As a result of amendments to sections 149.1(4.1), 149.1(22) and 188.2(2) of the ITA, if an “ineligible individual” is a member of the board of directors, a trustee, officer or equivalent official, or any individual who otherwise controls or manages the operation of the charity, then the charity may have its charitable status refused or revoked or may have its authority to issue charitable receipts suspended. Ineligible individuals include persons who:

- have been found guilty of a “relevant criminal offence” for which a pardon has not been granted – such offences include both offences under Canadian criminal law and similar offences outside Canada relating to financial dishonesty, including tax evasion, theft, fraud or any other criminal offence that is relevant to the operation of the charity;
- have been found guilty of a non-criminal “relevant offence” in Canada or outside Canada within the past five years – such offences relate to financial dishonesty, such as offences under fundraising legislation, consumer protection legislation or securities legislation, as well as any other offence that is relevant to the operation of the charity;
- have been a member of the board of directors, a trustee, officer, or an individual who otherwise controlled or managed the operation of a charity during a period in which the organization engaged in conduct that constituted a serious breach of the requirements for registration for which the charity had its registration revoked within the past five years – such conduct includes improper receipting arrangements, abusive tax shelters, or providing undue private benefit to directors; or
- have been at any time a promoter of a gifting arrangement or other tax shelter in which a charity participated and the registration the charity has been revoked within the past five years for reasons that were related to participation in the tax shelter.

² Minister of Finance, *The Next Phase of Canada’s Economic Action Plan: A Low-Tax Plan for Jobs and Growth* (Ottawa: Public Works and Government Services Canada, 2011) [Budget Plan]; *CRA 2011 Budget News*, online: Canada Revenue Agency <<http://www.cra-arc.gc.ca/gncc/bdgt/2011/menu-eng.html>>.

The CRA has clarified, however, that a charity will not necessarily have its charitable status refused or revoked simply because CRA has determined that an “ineligible individual” is on the board or manages the operation of the organization. CRA indicates that a charity will be given an opportunity to address any concerns CRA may have with an ineligible individual. The charity might put in place necessary safeguards over financial management, remove the individual in question or explain why it is appropriate for the individual to hold the position in question. CRA has also indicated that it will be developing detailed administrative guidance on how it will use these new provisions, but this guidance has not yet been made public.³

C. IMPLICATIONS OF THE “INELIGIBLE INDIVIDUAL” PROVISIONS

The “ineligible individual” provisions will potentially have extremely far reaching and unintended consequences. Consider the following example:

- Charity X has a 25 member board of directors
- Carter is a director on the board of Charity X
- Carter was also employed as the manager of another charity, Charity Y, in 2001-2002
- Charity Y is audited in 2004 in respect of the 2001 and 2002 taxation years
- In February 2006, Charity Y loses its status for substantial non-compliance, as a result of the imprudent actions of Charity Y’s board of directors, actions to which Carter strongly objected and that ultimately caused Carter to resign in 2002
- Because Carter managed a charity that lost its status for substantial non-compliance, Carter is now an “ineligible individual”
- He is an ineligible individual for the period of 5 years from the date of revocation in February 2006

³*Safeguarding Charitable Assets through Good Governance: Eligibility Requirements for Individuals who are Directors or Control or Manage Registered Charities and Registered Canadian Amateur Athletic Associations or Applicants for such Status*, online: Canada Revenue Agency <<http://www.cra-arc.gc.ca/gncc/bdgt/2011/qa22-eng.html>>

- The charitable status of Charity X could now potentially be revoked because an ineligible individual was/is on its board of directors

It is not clear what sort of due diligence will be required by a charity to ensure that an “ineligible individual” does not become involved or continue to be involved in its management.

Though a charity will not be required to conduct background checks, if the charity wanted to, from a risk management perspective and out of an abundance of caution, the information required to independently assess whether an individual is “ineligible” may not be publicly or easily available. For instance, there are challenges in discovering whether an individual has been found guilty of a criminal offence outside Canada; whether an individual has been found guilty of a relevant offence that is not tracked in publicly available databases in Canada and abroad; the names of Board members and like officials of revoked charities are not maintained on a single publicly-available list; and the names of individuals “who otherwise controlled or managed the operation” of a revoked charity rarely appear in a T3010. In fact, it is likely that the availability of much of this information is solely under CRA’s control.

Since most of the information is likely only available to CRA, it would be logical for the onus to be on CRA to maintain a list of “ineligible individuals”. Such a list may already exist internally for the purpose of enforcing these provisions. However, due to privacy and other legal concerns, it is unlikely that such a list would be made publicly available. Therefore, the onus is shifted to charities to comply in a situation where it is impossible to ensure 100% compliance because the necessary information is not available. Further, whatever due diligence a charity undertakes may be insufficient, because if CRA decides to revoke charitable status on the basis of the involvement of an “ineligible individual,” there is no due diligence defence available in the legislation.

At a minimum, charities will be required to implement some sort of screening mechanism in determining who will be asked to serve and/or can continue to serve on boards of directors or as senior staff. In that regard, the following list of questions, although not entirely comprehensive, could be asked of potential board members, trustees, officers and equivalent officials, and senior staff:

1. Have you ever been found guilty of a criminal offence in Canada relating to financial dishonesty, including tax evasion, theft, fraud or any other criminal offence that may be relevant to the operation of this charity, for which you have not been granted a pardon?
2. Have you ever been found guilty of a criminal offence outside of Canada relating to financial dishonesty, including tax evasion, theft, fraud or any other criminal offence that may be relevant to the operation of this charity, that if committed in Canada would be a criminal offence, and for which you have not been granted a pardon?
3. Within the past 5 years, have you been found guilty of a non-criminal offence within Canada relating to financial dishonesty, such as offences under fundraising legislation, consumer protection legislation or securities legislation, or any other offence that may be relevant to the operation of this charity?
4. Within the past 5 years, have you been found guilty of a non-criminal offence outside of Canada relating to financial dishonesty, such as offences under fundraising legislation, consumer protection legislation or securities legislation, or any other offence that may be relevant to the operation of this charity?
5. Have you been a member of a board of directors, a trustee, officer, or an individual who otherwise controlled or managed the operation of a charity in the past five years?
 - If so, has this charity had its charitable registration revoked in the past five years?
 - If so, was the charitable status revoked as a result of conduct that constituted a serious breach of the requirements for registration, including improper receipting arrangements, abusive tax shelters, or providing undue private benefit to directors?
6. Have you, at any time, been a promoter of (sold or promoted the sale on your own or someone else's behalf) or otherwise been involved with a gifting arrangement or other tax shelter in which a charity participated and the registration the charity has been revoked within the past five years for reasons that were related to participation in the tax shelter?

Charities will also have to consider how to deal with issues involving current directors, including whether, how and how often they should be screened. For instance, charities may want to develop a parallel questionnaire for current board members and require that the questionnaire be completed on an annual basis or as a condition of re-election to the Board. Charities will also want to consider how current board members are to be removed if they do become “ineligible individuals.” Typically, only the members of the charity are able to remove directors from the board.

D. CONCLUSION

The new “ineligible individual” provisions create another burden on charities that is not imposed upon any other private entity and is far beyond the federal government’s jurisdiction over taxation. While the department of Finance specifies that charities will not be required to conduct criminal record checks, it is clear that charities will be required to implement some sort of screening process for current and future members of their boards of directors, which may become a disincentive for individuals to serve on the boards of charities. Of possibly even greater concern are the “ineligible individual” provisions as they relate to individuals that may have controlled or managed a charity, as these provisions are clearly intended to also apply to senior paid staff. In addressing this risk with employees, employers will also be well advised to consider compliance with employment standards and human rights legislation, when implementing the screening process and in removing “ineligible” individuals.



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