
IMPLICATIONS OF ONTARIO BUDGET CUTS FOR ONTARIO NOT-FOR-PROFITS

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A. INTRODUCTION

On April 11, 2019, the Ontario Government released the 2019 Budget (“Budget”),¹ which included a number of financial measures that will result in a reduction in provincial government funding for many not-for-profits in Ontario. The Ontario Nonprofit Network (“ONN”) recently released a summary of the Budget, which provided the ONN’s perspective and views on the Budget for the not-for-profit sector in Ontario.²

Any material reduction in government funding may have serious consequences concerning the viability of impacted charities and other not-for-profits. Boards of organizations facing either a reduction or an elimination of government funding will be faced with serious decisions and choices concerning the continued operation of their programs, or possibly even the continued existence of the organization itself. The purpose of this *Bulletin* is to provide an overview of some of the more important issues that charities and other not-for-profits facing imminent reduction or elimination of provincial government funding may need to consider.

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¹ Ontario, Minister of Finance, *2019 Ontario Budget: Protecting What Matters the Most*, (Toronto: Ministry of Finance, 11 April 2019), online at: <www.ontario.ca/budget>.

² Ontario Nonprofit Network, “Provincial Budget 2019” (last accessed 13 May 2019), online: *Ontario Nonprofit Network* <theonncan.ca/our-work/our-financing/provincial-budget-2019/>.

B. ISSUES TO CONSIDER

1. Government Funding Agreements – Know Your Rights and Obligations

If a charity or other not-for-profit is in receipt of provincial government funding, there will likely be a funding agreement in place. Should a notice be received from the provincial government stating that funding will be reduced, the funding agreement is being terminated, or a portion of funding provided by the provincial government is to be returned, organizations will need to review their rights under the funding agreement and obligations in the event of termination. There may be contractual notice requirements which state the method and timing by which funding may be reduced or eliminated. As these are contractual requirements, impacted organizations will need to make sure that the proper notice is provided, and respond accordingly if the government is not acting in accordance with the terms of the agreement.

Further, if the organization determines that the reduction or elimination in provincial government funding will necessitate the winding up and dissolution of their organization, there may be the opportunity to negotiate the issue of wind-up costs with the government, which could be substantial, depending on the nature and operations of the organization. As well, on termination of the agreement, the organization will need to determine whether any intellectual property or other materials licensed from the provincial government or other agency need to be returned, and whether any sub-licensees have similar obligations to the organization. For example, if the organization is to continue operating without funding, the corporate name and other branding of the organization may need to be changed if required under the funding agreement.

2. Consider Options and Strategy

Once an organization is properly notified of the reduction or elimination of government funding, executive management and the board of directors will need to carefully consider the immediate consequences and potential strategic options, including matters such as:

- a) Can the organization continue to function, and if so, for how long?
- b) If the organization is capable of continuing, can certain programs be eliminated or reduced in scope?

- c) If programs need to be eliminated in order for the organization to remain financially sustainable, how will the organization notify the beneficiaries/participants of the programs and manage the program wind down process?
- d) Are there other funding sources potentially available either in the short- or long-term?
- e) Can the organization remain financially viable by reducing its costs, including terminating some of its employees or selling certain assets?
- f) Can any of the organization's programs be transferred to another charity or not-for-profit with the resources to maintain those programs?
- g) If it is determined that the organization is not able to continue on its own, are there opportunities to join with other organizations, e.g., by amalgamation or other type of merger?
- h) If the organization is to be wound up and dissolved, how will the resulting liabilities to creditors (including terminated employees, contractors, service providers, landlords, Canada Revenue Agency, etc.) be paid?
- i) In the event that the organization may have insufficient assets to pay all creditors, could the individual board members be left potentially subject to personal liability for any unpaid debts?

As such, there are numerous issues to carefully consider and review prior to any decisions being made. As part of their fiduciary duties, the board needs to consider the strategic alternatives that may be available to the organization. As part of the review process, the board should have available updated and current documentation with respect to the organization's financial situation, its material contracts (including contracts with employees and suppliers) and its insurance policies, including Commercial General Liability Insurance, and Directors and Officers Liability insurance, as well as any outstanding or potential claims. Prior to any final decisions being made, the board will need to consider obtaining professional advice from the organization's legal and financial advisors.

3. Potential Liabilities to Terminated Employees and Others

If an organization decides that some or all of its employees need to be terminated, the board will need to carefully consider the potential costs. Depending on the tenure of the employees and their compensation, termination costs could be very substantial. If there is a written employment contract with a termination clause, this could limit the amounts payable upon termination.³ However, contractual termination clauses need to be carefully reviewed, because if they are not legally

³ See Barry W Kwasniewski, "The Ins and Outs of Wrongful Dismissal For Charities and Non-Profits" (20 January 2009) *Charity Law Bulletin No 153*, online: *Carters Professional Corporation* <www.carters.ca/pub/bulletin/charity/2009/chylb153.htm>.

enforceable, the employee would retain his or her rights to compensation based on common law principles. Common law termination entitlements are based on the legal concept of “reasonable notice”, which in many cases will substantially exceed the minimum notice/pay in lieu of notice, and severance pay (if applicable) requirements under the Ontario *Employment Standards Act, 2000*.⁴ The fact that an employee is being terminated as result of a reduction in funding from the government will not disentitle them to their legal rights to appropriate termination compensation.

Further, if an organization is in financial difficulty, directors need to be kept informed by executive management that employees are continuing to be paid on schedule, and that the appropriate tax deductions and other statutory remittances are also being deducted and remitted as legally required. Under Ontario and federal corporate law, directors of a corporation may be held jointly and severally liable in an amount not to exceed the equivalent of six months unpaid wages to each employee.⁵ Under federal laws, directors can also be held personally liable for amounts that should have been remitted for income taxes and other source deductions from employee pay, such as Canada Pension Plan⁶ and Employment Insurance⁷ contributions.

In the event that the organization deteriorates to the extent that employees and other creditors are not being paid, the organization may have become insolvent. If that were to occur, the board would need to seek advice from an insolvency professional without delay in order to reduce the risk of potential personal liability, in addition to liability for the organization. Retaining the appropriate financial, legal and other professional advisors to provide informed advice on these issues in a timely manner is crucial. If developments warrant, it may be necessary to seek protection from creditors under either the *Companies’ Creditors Arrangement Act*,⁸ or the *Bankruptcy and Insolvency Act*.⁹

4. Winding up and Dissolution of the Organization

If the board decides that the voluntary windup and dissolution of the organization is the best option under the circumstances, there are a number of issues to consider, including:

⁴ *Employment Standards Act, 2000* (Ontario), SO 2000, c 41.

⁵ *Corporations Act* (Ontario), RSO 1990, c C.38, s 81 [OCA]; *Canada Not-for-profit Corporations Act*, SC 2009, c 23, s 146. [CNCA]

⁶ See *Canada Pension Plan*, RSC 1985, c C-8.

⁷ See *Employment Insurance Act*, SC 1996, c 23.

⁸ *Companies’ Creditors Arrangement Act*, RSC, 1985, c C-36.

⁹ *Bankruptcy and Insolvency Act*, RSC, 1985, c B-3.

- a) Winding up the operations of an organization does not necessarily mean that the organization needs to be immediately dissolved. There may be considerations involved in delaying dissolution that should be considered, such as continued corporate indemnification of directors and officers, as well as insurance considerations that should be carefully reviewed with legal counsel.
- b) The organization should review its governing documents if it is a corporation for a dissolution clause that would normally lay out the default obligations of the organization with respect to the distribution of any remaining property upon dissolution.
- c) As well, if the organization is incorporated, it will need to ensure that its dissolution process complies with applicable corporate legislation, e.g. the Ontario *Corporations Act* (“OCA”), *Canada Not-for-profit Corporations Act* (“CNCA”),¹⁰ as well as any common law requirements. Obligations under corporate legislation may include filing requirements, such as filing an application for surrender of charter under the OCA or articles of dissolution under the CNCA, and other governance requirements, such as board and membership authorization of these documents, as well as requirements regarding the distribution of property.
- d) If the organization is a registered charity, it will need to request a voluntary revocation of its charitable registration with the Canada Revenue Agency and transfer any of its remaining assets to an arm’s length charity (referred to as an “eligible donee”) or otherwise become subject to a 100% revocation tax under the *Income Tax Act*.¹¹ If the organization is holding any charitable property that is subject to restrictions concerning the use of the charitable property or the length of time it is to be held, the deeds of gift or other documentation will need to be reviewed to ensure that these restrictions can be complied with in transferring them to another charity. In addition, if the organization is a registered charity incorporated under the OCA it must obtain approval from the Ontario Public Guardian and Trustee to dissolve the corporation.
- e) Ontario legislation with regard to forfeited property may apply where a charity or not-for-profit dissolves without properly disposing of its property as provided for under the *Forfeited Corporate Property Act, 2015*¹² and *Escheats Act, 2015*.¹³ Property of a registered charity that is an Ontario corporation that is not distributed is forfeited to the Crown.¹⁴

¹⁰ *CNCA, supra* note 5.

¹¹ *Income Tax Act, RSC, 1985, c 1 (5th Supp).*

¹² *Forfeited Corporate Property Act, 2015, SO 2015, c 38, Sched 7.*

¹³ *Escheats Act, 2015, SO 2015, c 38, Sched 4.*

¹⁴ *OCA, supra* note 5, s 322.

5. Insurance Considerations

As noted above, directors should obtain and review the organization's directors and officers liability insurance policies to ensure a broad scope of coverage, and that the directors and officers have coverage for liabilities that they are statutorily liable to pay on a personal basis due to the insolvency of the organization. In the event of an insolvency of the organization, any indemnities the directors may have from the organization will likely be of little or no value, so any insurance available will likely be the sole source of protection to any affected directors or officers of the organization.

In the event of a voluntary windup and dissolution, there remains a legal risk of claims coming forward. Therefore, as part of the windup process the organization should seek to obtain "tail coverage" under its liability insurance policies. The duration of the tail coverage would need to be reviewed by the organization with its insurer or insurance broker to properly protect the organization, and its directors and officers from claims which may arise subsequent to the date of dissolution, including any claims which may arise as a result of the delivery of programs.

C. CONCLUSION

A sudden and unanticipated reduction or elimination in government funding raises significant challenges to charities and not-for-profits, as well as their boards. The recent Budget has brought these issues to the forefront for affected charities and other not-for-profits in Ontario. As fiduciaries, directors of charities and not-for-profits will need to continue to act in the best interests of the organization for which they serve, and will need to carefully assess the impact of any government funding decision on the organization's overall programming and financial viability. There are no easy answers when dealing with funding cuts. However, directors need to equip themselves with the information necessary to make informed and important decisions. In doing so, they should obtain advice from their legal counsel and other professional advisers as necessary before making any key decisions.