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**UNITED WAY/CENTREAIDE  
WINDSOR – ESSEX COUNTY**

**Windsor - January 19, 2006**

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**Compliance Issues for Charities and Not-for-Profit Organizations: A Pro-active Approach**

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**OVERVIEW OF PRESENTATION**

- The Need for Due Diligence in Addressing Compliance Issues
- Identifying the Differences Between Charities and Not-for-Profit Organizations
- Identifying the Different Types of Legal Forms of Organizations
- Organizational and Legal Documentation
- Bill C-21 (*Canada Not-for-Profit Corporations Act*)
- Utilizing Multiple Corporations
- Board Management Issues
- Reducing Board Liability
- Insurance Considerations

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- Third Party Use of Property
- Real Property Issues
- Intellectual Property Issues
- Employment And Volunteer Issues
- Investment Issues
- Donor Restricted Trust Funds Issues
- Maintaining Charitable Registration
- National/International Relationships
- Anti-Terrorism/Money Laundering Issues

**Note:** For more details see Legal Risk Management Checklist, articles and newsletters at [www.charitylaw.ca](http://www.charitylaw.ca), [www.churchlaw.ca](http://www.churchlaw.ca) and [www.antiterrorism.ca](http://www.antiterrorism.ca)

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**THE NEED FOR DUE DILIGENCE IN ADDRESSING COMPLIANCE ISSUES**

- Charities and not-for-profit organizations collectively make up an essential part of Canadian society and its economy
- Charities and not-for-profits constitute the third sector of the economic engine of Canada
- Charities and not-for-profits are facing fundamental changes and challenges in delivering their services to the public, in part because of a more litigious society

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- **In facing these challenges charities and not-for-profits must become familiar with a vast array of legal requirements ranging from corporate law and trust law to tax and international structures and agreements**
- **In order for charities and not-for-profits to comply and avoid exposure to legal liability, it is essential that they exercise due diligence in addressing compliance issues with legal obligations**

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- **Due diligence in addressing compliance issues involves the charity and the not-for-profit asking the following basic questions:**
  - **Who they are legally**
  - **What are their legal obligations**
  - **How can they effectively comply with those legal obligations**

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- **Due diligence must be undertaken in a pro-active manner in order to avoid legal problems before they occur**
- **The approach must change from benign passivity to pro-active legal risk management**
- **What follows is a series of key considerations and issues that charities and not-for-profits should address in order to identify and comply with basic legal requirements**

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**IDENTIFYING THE DIFFERENCES BETWEEN CHARITIES AND NOT-FOR-PROFIT ORGANIZATIONS**  
**Charities**

- **What is a charity?**
  - **At common-law a charity includes**
    - **Relief of poverty**
    - **Advancement of education**
    - **Advancement of religion**
    - **Other purposes beneficial to the community recognized by the courts**

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- **Under the *Charities Accounting Act* – “charitable purpose” is defined**
  - **Codifies the common law definition of what is a charity**
  - **Definition does not extend to broader definition under the *Income Tax Act***
- **Under the *Income Tax Act* – “qualified donees” concept was introduced**
  - **Includes a “registered charity”**
    - **Defined as “charitable organization”, “public foundation” and “private foundation”**

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- **No definition of a “charity” but reflects the common law definition**
- **Includes extended statutory list of “qualified donees”**
  - **Registered Canadian amateur athletics associations**
  - **Low-cost housing co-operatives for the aged**
  - **Municipalities**
  - **United Nations**
  - **Prescribed universities**
  - **Her Majesty in right of Canada or a province**

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- **What are the tax advantages of being a charity?**
  - A charity does not pay tax on income or capital gains
  - A charity can issue charitable receipts to donors as tax credits for income tax purposes
  - A gift for income tax purposes can now include consideration back to the donor
- **What are the legal forms available for a charity?**
  - Charitable trusts
  - Unincorporated associations
  - Non-share capital corporations

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- Not-for-profit Organizations**
- **What is a not-for-profit organization under the *Income Tax Act*?**
    - Club, society or association
    - Must not be a charity
    - Organized and operated exclusively for social welfare, civic improvement, pleasure or recreation, or any other purpose, except profit
    - No part of the income can be payable or available to any proprietor, member or shareholder

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- **What are the tax advantages of being a not-for-profit organization?**
  - A not-for-profit organization does not pay tax on income or capital gains, except income from property of an organization whose main purpose is to provide dining, recreation or sporting facilities
  - A not-for-profit organization cannot issue charitable receipts for income tax purposes

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- What are the legal forms available for not-for-profit organizations?
  - Unincorporated associations
  - Non-share capital corporations
- Examples would include
  - Recreational clubs
  - Service clubs
  - Trade associations
  - Professional associations

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**IDENTIFYING THE DIFFERENT TYPES OF LEGAL FORMS FOR ORGANIZAITONS**

- Unincorporated associations
  - Not a legal entity
  - Generally used for starting up not-for-profit or charity
  - Flow through liability to members

The diagram shows a dashed circle containing the text "Executive Members" and three rows of "o o o o o". An arrow labeled "claims" points from the left into the circle.

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- Trusts
  - Separate legal entity
  - Available for both not-for-profits and charities
  - Trustees are exposed to liability

The diagram shows a dashed circle divided horizontally. The top half is labeled "Trustees" and the bottom half "Purpose". An arrow labeled "claims" points to the "Trustees" section. Arrows labeled "beneficiaries" and "donors" point to the "Purpose" section.

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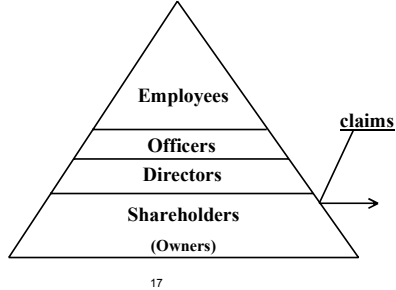
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- Share capital corporate organizations
  - Separate legal entity
  - can be used for either a for profit or a not-for-profit organization



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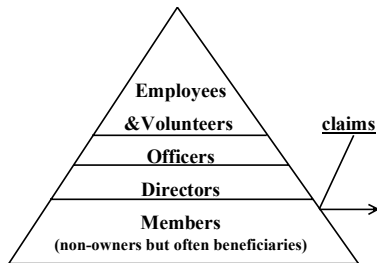
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- Non-share capital corporate organizations
  - Separate legal entity
  - As used for a not-for-profit organization



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- Non-share capital corporate organizations
  - As used for a charitable corporation



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**ORGANIZATIONAL AND LEGAL DOCUMENTATION**

- **General overview of organizational & legal documentation**
  - **Identify the existence and the location of key organizational and legal documents**
    - **Develop an inventory of key documents**
    - **Maintain central location for key documents**

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- **Identify key organizational documents for an unincorporated association**
  - **Constitution and amendments , if applicable**
  - **Policies and procedures, if applicable**
- **Identify key organizational documents for an incorporated organization**
  - **Letters patent and supplementary letters patent, if applicable**

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- **Membership covenant and mission statement, if applicable**
- **By-laws and resolutions**
- **Directors, members and debt registers**
- **Copies of government filings**
- **Identify other key legal documents**
  - **Leases, deeds and mortgages**
  - **Agency, partnership and joint venture agreements, contracts for service**
  - **License agreements**

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- Business name, trade-marks, official marks and domain names
- Charitable registration number, T3010's and correspondence from CRA
- Policy statements, i.e. sexual abuse and volunteer policy statements
- Historical record of insurance policies
- Privacy policies
- Investment policies
- Review of key documents for an unincorporated association
  - Are the objects clearly stated in the constitution and are they not-for-profit in nature or are they charitable in nature?

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- Do constitutional documents correctly reflect how the organization is actually structured and operated?
- For charitable organizations, is a copy of the constitution filed with the appropriate government agencies, i.e. with Canada Revenue Agency ("CRA") and the Public Guardian and Trustee ("PGT")?
- Review of key documents for an incorporated organization
  - Review of letters patent
    - Is the name in the letters patent the correct name of the organization and is it consistent with the objects?

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- Are its objects appropriate for a not-for-profit organization, i.e. are they not charitable, or for a charity, are they exclusively charitable in nature?
- Are the activities of the organization authorized by its corporate objects?
- For a not-for-profit organization, is the dissolution clause complementary to the objects or does it provide for distribution to its members?
- For a charity, does the dissolution clause provide for distribution to other charities
- Review of supplementary letters patent (SLP)
  - Have all SLPs been identified
  - Has there been a change of corporate name?
  - Has there been a change of corporate objects?

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- Letters patent of amalgamation (only for Ontario corporations):
  - Are the objects the same or similar?
  - What are the terms of the amalgamation agreement?
- Does the organization have historical records of all the by-laws
- Need to review the current corporate by-law for basic terms, such as
  - Do provisions conflict with letters patent concerning objects or dissolution?
  - Do the provisions reflect the actual organization and operational structure of the organization?

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- Does the by-law reflect recent changes to applicable corporate legislation?
- Is there an adequate indemnification provision for the directors?
- Are the by-law amendment procedures consistent with corporate legislation?
- Was initial corporate organization of the corporation properly done?
- Was there a documented transfer of assets and liabilities on incorporation?
- Are the records of board decisions and/or membership meetings complete?

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- Is there adequate board and/or members' authorization for indebtedness, if applicable?
- Have corporate records generally been properly maintained, such as consent to be directors and applications for membership?
- Where are the corporate records kept?
- Have necessary corporate filings and registrations been kept up to date?
  - Ontario Corporations
    - Initial Notice and Notice of Change - Form 1
    - *Business Name Act* (Ontario) registrations

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- **Mandatory reporting to Public Guardian and Trustee for charitable organizations**
- **Federal Corporations**
  - **Annual Summary (Form 3) - Canada**
  - **Extra-Provincial Initial Notice (Form 2) - Ontario**
  - **Business Name Act (Ontario) registrations**
  - **Mandatory reporting to Public Guardian and Trustee for charitable organizations**

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- **Does the organization operate and/or fundraise in any other provinces? If so, there may need to be registration as extra-provincial corporations in other provinces, together with business name registrations**
- **Does the organization need to continue itself under the proposed new *Canada Not-for-Profit Corporations Act*?**
- **Has there been loss of corporate status for failure to maintain government filings?**
- **Is the organization aware of the importance of proper use of corporate name and operating names?**

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- **Has the organization developed and implemented risk management policy statements concerning:**
  - **child protection**
  - **sexual harassment**
  - **bullying**
  - **volunteer recruitment**
  - **safety in the workplace**
  - **protocol for foreign volunteer projects**
- **Has the organization conducted an up to date inventory of its assets?**

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**BILL C-21 (CANADA NOT-FOR-PROFIT CORPORATIONS ACT)**

**Bill C-21: An act respecting not-for-profit corporations and other corporations without share capital**

- **First reading: November 15, 2004**
- **Will replace *Canada Corporations Act (CCA)***
- **Modelled on the *Canada Business Corporations Act***
- **All existing CCA corporations will be required to continue under the new act within 3 years of it coming into force**

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**Highlights of Bill C-21**

- **Streamlined incorporation “as of right” – incorporation will be granted upon filing required forms and payment**
- **Incorporation will take a matter of hours instead of weeks**
- **No filing of by-laws required**
- **More corporate fundamental changes possible, i.e. amalgamation and continuance**
- **Corporations will have the power of a natural person**

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- **Efficient process for special act corporations to be continued under new act**
- **Rights of members better enhanced and protected, but may be problematic when dealing with non-voting members where fundamental corporate changes are required**
- **An objective standard of care and a due diligence defence for directors and clarifies directors and officer duties**
- **Directors will have a right of dissent**
- **Graduated levels of financial review required depending on a corporation’s category and gross annual revenue**
- **Requirement to provide financial statements to members, directors and officers as well as to the director under the legislation**

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**Timing**

- **The future of the legislation is now uncertain because of the pending federal election**
- **Changes are expected to be made to the legislation when it is re-introduced**
- **In any event, the organization needs to file annual summaries, as Industry Canada is dissolving all federal corporations that are not in good standing in meeting their filing requirements before new act is in force**

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**UTILIZING MULTIPLE CORPORATIONS**

- **Should the organization consider using multiple corporations for its high risk activities in order to reduce liability exposure and protect assets?**
- **Different types of multiple corporations that can be implemented**
  - **Parallel operating organizations**
  - **Parallel charitable foundations**
  - **Umbrella organizations**

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- **Has appropriate consideration been given to balancing control of multiple corporations with issues involving the possibility of cross over liability?**
- **Has appropriate consideration be given to implementing effective control through contracts and/or licensing agreements as an alternative to overt corporate control?**

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**BOARD MANAGEMENT ISSUES**

- **Is the organization able to identify who is in charge of the organization?**
  - Where does the de facto control of the organization lie? Is it with a board, a committee or executive staff?
  - Is board authority recognized by the membership?
- **Are there clearly defined lines of authority between the board and the executive staff?**
- **Does the board meet on a regular basis and do directors regularly attend?**

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- **Has the board delegated too much responsibility to executive staff by restricting itself to policy development only without a careful and ongoing monitoring and review of policy implementation?**
- **Has an audit committee been established by the board to review financial statements and the auditors' report?**
- **Has the board established a comprehensive due diligence review process by establishing and utilizing a legal risk management checklist?**

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- **Has a risk management committee of the board been established?**
- **Is there adequate communication of board responsibilities to existing and new board members?**
  - Need to create a board binder of all organizational documents and inventory of assets, as well as an explanation of the general operations of the organization and the board of directors' legal duties and liabilities
  - Need to provide regular updates on changes in the law to board members

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**REDUCING BOARD LIABILITY**

- Do any directors of a charity receive direct or indirect remuneration that has not been disclosed to the full board of directors? Otherwise, all board members maybe jointly and severely liable
- Has the organization adequately indemnified its directors and officers, and for a charitable organization has the indemnification been done in accordance with the *Charities Accounting Act*?
- Has the board of a charity authorized the organization to acquire directors' and officers' liability insurance, in accordance with the *Charities Accounting Act*?

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- Should the organization consider reducing the size of the board to limit the number of people who are exposed to liability as directors?
- Is the organization effectively making use of committees as an alternative to a large board of directors?
- Should the organization consider implementing an advisory board to complement the board of directors without a corresponding exposure to liability?

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**INSURANCE CONSIDERATIONS**

- Has the organization maintained a historical record of its insurance coverage in the event of a future claim?
- Does the organization know whether it has occurrence-based or claims-made insurance coverage for sexual abuse?
- Has the organization provided full written disclosure on a regular basis of all risks to its insurer to avoid denial of coverage?
- Does the organization require regular reports from its insurance broker on existing coverage, exclusions from coverage and recommendations to enhance coverage?

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- Is there a regular review of the adequacy and extent of general liability coverage and property insurance?
- Is there a regular review of directors' and officers' liability coverage?
- Does there need to be special insurance endorsements to extend insurance coverage in "out of the ordinary" situations, e.g. activities of volunteers and agents in foreign countries?

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**THIRD PARTY USE OF PROPERTY**

- Has the organization been made aware of potential liability exposure in permitting third parties to use its property?
- Has the organization developed and implemented a third party facility use agreement with appropriate releases and indemnification?
- Does the organization require evidence of liability insurance from third party users of its facilities?
- Has the organization provided written notice to its insurer concerning the use of its property by third parties

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- Does the organization charge appropriate fair market rental fees to users of these properties?
  - Charitable property requires fair market value for rent charged to non-charities
  - Non-charitable properties have more flexibility in the amount of rent that it can charge
- Does the organization have the corporate authority to allow third party use of its property?
- For organizations that are charities, does the third party use constitute an unrelated business prohibited by the *Income Tax Act*?
- For religious charities involved with same-sex issues, has consideration been given to compliance with recent amendments under the *Human Rights Code* (Ontario)?

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**REAL PROPERTY ISSUES**

**Deeded land**

- **Has an environmental assessment been conducted to determine the extent of liability exposure for the organization for future acquisitions as well as existing property?**
- **If the organization has fuel oil tanks, either above or below ground, has there been compliance with new mandatory provincial fuel oil tank regulations?**
- **Are there trust provisions in old title documents that may impact real property held by a charitable organization that should be varied by a court?**

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- **Has the organization addressed and rectified encroachments with neighbouring lands?**
- **Are municipal zoning and legal non-conforming uses being complied with?**
- **Could a charity be forced to sell surplus land or risk vesting of land in the Public Guardian and Trustee after three years under *Charities Accounting Act* (Ontario)?**
- **Has the organization reviewed its municipal property tax assessment to determine both classification and valuation and if so has there been a request for reconsideration or appeal of assessment?**

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**Leased Land**

- **Need to avoid personal guarantees on lease document as much as possible**
- **Avoid clauses requiring restoration of leased premises at the end of the lease**
- **Ensure access to adequate parking**
- **Need to limit the extent of tenant expenses under a net lease arrangement**
- **Ensure the right to sub-let and assign the lease, with a release, if possible**
- **Need to address issues of environmental liability for both the landlord and the tenant**

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- Need to carefully monitor the date by which an option to renew the lease needs to be exercised
- The amount of rent on renewal should be made subject to arbitration
- Try to obtain a covenant from the landlord to prohibit offensive uses of adjoining leased premises
- Does the lease need to be registered on title?
- Try to obtain a right of first refusal to lease adjoining leased premises

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- INTELLECTUAL PROPERTY ISSUES**
- Intellectual property is an essential asset of an organization and consists of both trade-marks and copyright
  - Trade-marks need to be identified, licensed and enforced
  - Trade-marks can be lost if they are not properly protected
  - An organization needs to be pro-active in protecting its trade-marks or risk losing its trade-mark rights by default
  - Registration of a corporate name or business name does not by itself give trade-mark protection

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- Trade-mark rights exist at common law but those rights are limited and should be protected by trade-mark registration under the *Trade-marks Act*
- There is enhanced trade-mark protection available for those organizations that qualify as public authorities under the *Trade-marks Act* for official marks
- Separate trade-mark registration must be done in each country in which the organization is operating
- It is essential that a trade-mark be properly marked with either a <sup>TM</sup> for an unregistered trade-mark or a ® for a registered trade-mark

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- It is essential to properly use and license trade-marks, otherwise the trade-mark can be lost
- An infringement of a trade-mark by others, even if done unintentionally, must be immediately challenged
- The board members and executive staff of an organization need to be informed of the importance of trade-mark rights
- The organization should develop a portfolio management approach to identifying, registering, using and protecting trade-marks, both in Canada and in other jurisdictions as applicable

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- In addition to obtaining a trade-mark registration, an organization should secure multiple domain names as soon as possible using its trade-mark as part of the domain name
- Has the designer of the organization’s website assigned the copyright for the website design?
- Who owns the copyright for publications of the organization and is it properly identified with a notice of copyright protection, i.e. ©?
- Should the copyright material of the organization be registered, assigned or licensed?

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- EMPLOYMENT AND VOLUNTEER ISSUES**
- Has the organization developed appropriate policies and practices for hiring, disciplining and terminating employees and volunteers?
  - Does the organization have a policy in place concerning accommodation for employees who are members of a disadvantaged group identified in the Ontario *Human Rights Code*?
  - Does the organization have a policy concerning sexual harassment?

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- Is there a need to develop and adopt statements and/or manuals for employees as well as volunteers in relation to conduct and performance structure?
- Do employees and volunteers who deal with children need to be screened and supervised in accordance with an appropriate sexual abuse policy statement?
- Is the organization aware of and addressing ownership issues regarding intellectual property created by the employees and volunteers?

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- Is the organization aware of and complying with applicable statutory requirements, such as pay equity, employment standards, human rights legislation, privacy legislation and occupational health and safety prerequisites?
- Is the organization and the board exposed to criminal liability under the *Criminal Code* i.e. Bill C-45 (Westray Mines)?

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**INVESTMENT ISSUES**

- What investment powers apply to investment of surplus funds of the organization?
  - Investment power may be found in the letters patent or supplementary letter patent
  - Investment power may be found in incorporating legislation
  - Investment power may be found in the *Trustee Act* (Ontario), particularly for a charity

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- Does the organization need and/or have an investment policy?
  - Documenting compliance with prudent investor rule
  - Establishing requirements for delegation of investment decision making, particularly for a charitable organization
  - Proper management of endowed funds
- Are charitable funds being used to fund separate business operations of the charitable organization?
- Is there violation of the *Charitable Gifts Act* (Ontario) by a charitable organization owning more than 10% of a business as an investment?

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- DONOR RESTRICTED TRUST FUND ISSUES**
- Are there donor restricted trust funds being held by the charity?
    - Building funds
    - Endowment funds
    - Special project funds
    - Ten year gifts
  - Are restricted funds used only in accordance with applicable restrictions?

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- Are restricted funds being used in whole or in part for general operational purposes or are they being borrowed against? In either event there would be breach of trust.
- Are restricted funds segregated from operating funds?
- If not, is there compliance under the *Charities Accounting Act* (Ontario) to co-mingle restricted funds for investment purposes?
- Is the board of the charitable organization aware of the consequences of breach of trust for failing to comply with restricted funds?

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**MAINTAINING CHARITABLE REGISTRATION**

- Is the legal name of the charity and/or its operating name consistent with the records of CRA?
- Does CRA have the current head office address of the charity?
- Has the charity obtained Quebec charitable status for fundraising in Quebec?
- Does the charity submit its annual charity information return (form T3010) on a timely basis?
- Is the charity and its directors aware of the recent key amendment to the *Income Tax Act* in May/2005 concerning the disbursement quota as outlined below?

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- The 4.5% disbursement quota is reduced to 3.5%
- The 3.5% disbursement quota is extended to charitable organizations
- Inter-charity transfers to charitable organizations are now subject to the 80% disbursement quota
- The 80% disbursement quota can be delayed through utilizing “enduring property” including ten year gifts
- Inter-charity transfers have become more complicated

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- Is the charity and its directors aware of the new penalties and sanctions that are part of the May/2005 amendments to the *Income Tax Act*?
- Is the charity and its directors aware of the key amendments proposed to the *Income Tax Act* in July/2005 dealing with split receipting and anti-tax shelter provisions outlined below?
  - New split receipting rules will apply, which will permit the donor to receive some consideration when making a gift
  - New broader definition of “advantage” may reduce the amount of a charitable receipt
  - New broader definition of a charitable organization and public foundation will apply

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- Complicated new rules to curtail tax shelter schemes may result in reduction of charitable receipts for gifts in kind
- Charities will need to make reasonable inquiries of donors for all gifts, whether gifts in kind or cash
- New expanded basis for revocation of a charity will apply
- Different proposed changes have different effective dates, some are retroactive
- Is the charity involved in political activities and if so are they operating within limits permitted by CRA?

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- Is the charity involved in business activities and if so, are they operating within the related business guideline permitted by CRA?
- Has a not-for-profit housing corporation that is not currently a charity considered whether it needs to become a registered charity in order to avoid becoming taxable?
- Are agency, joint venture relationships or contractual transfer arrangements with non-qualified donees properly documented?
- Does the board of directors review the annual return (T3010A) for the charity before it is filed each year?
- Is the charity prepared for a spot audit by CRA?

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- NATIONAL/INTERNATIONAL RELATIONSHIPS**
- Multi-tiered provincial or national charities
    - Single corporate structure provides ease of administration, but results in greater risk of liability exposure for total assets of single corporate entity
    - Multiple corporate structure reduces risk of liability, but top tier organization may still be exposed to liability where too much control is imposed or employer/employee relationship exists
    - The reverse is also a risk: top-tier corporations can lose control over subsidiaries without proper corporate control in place and/or appropriate agreements

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- Are relationships with national organizations and/or subsidiary chapters adequately documented to protect the rights of both parties?
- Are relationships between national and international structures adequately documented with specific reference to controlling trademark in Canada?
- Is there need for an international umbrella organization?
- Has the ownership of trade-marks and/or copyrights been determined and protected in Canada?
- Have trade-marks and copyrights been adequately protected and licensed?

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- ANTI-TERRORISM/MONEY LAUNDERING ISSUES**
- Does the organization carry on operations that may require it to be in compliance with anti-terrorism/money laundering legislation?
    - International operations
    - Domestic operations
  - Has the organization undertaken appropriate due diligence procedures in complying with anti-terrorism/money laundering legislation?
    - Development of an anti-terrorism/money laundering policy statement.

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- Development of resource materials on anti-terrorism/money laundering legislation
- Requiring disclosure statements for board members and staff
- Evaluating all organization programs for compliance
- Requiring disclosure statements from affiliated organizations, third party agents and/or partners and conducting appropriate inquiries
- Determining when to make inquiries of donors
- Conducting due diligence internet searches on directors, officers and agents

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- Are directors aware of risks associated with failing to comply with anti-terrorism/money laundering legislation?
  - Loss of charitable status
  - Personal liability in civil law
  - Possible criminal law sanction

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