

Not-For-Profits: An Introduction to the New Legislation

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Introduction

Both Canada federally and Ontario provincially have revised their legislative schemes for not-for-profit corporations (“NFPs”). The federal legislation is called the *Canada Not-For-Profit Corporations Act* (“Federal Act”). The Ontario legislation is called the *Not-For-Profit Corporations Act, 2010* (“Ontario Act”). Both statutes are expected to come into force before the end of 2012 and are meant to “modernize” their respective not-for-profit sectors.

It is important to know is that **these changes apply to all existing NFPs**, not just new NFPs that are incorporated after the new Acts come into force.

All existing federal and Ontario NFPs should review their existing constitutional documents and take steps to bring themselves into conformity with the new Acts. The sooner they start this process the better.

Also, these changes only relate to corporate governance. NFPs that are or want to be charities for income tax purposes have to comply with Canada Revenue Agency (“CRA”) requirements related to obtaining and maintaining charitable status, and **the CRA charitable status guidelines are not changed by these statutory reforms.**

Continuation and Transition Issues for Existing NFPs

Ontario: A Deemed Amended Approach - The Ontario Act applies to all Ontario NFPs as soon as it comes into force. All Ontario NFPs will have to review their Letters Patent and by-laws and consider what amendments they need to make in order to comply with the new legislation. Ontario NFPs that do nothing will be deemed to have amended their Letters Patent and by-laws to comply with the Ontario Act on the third anniversary of its coming into force, and any provisions in their Letters Patent and by-laws that are not in compliance with the new Act will be deemed to be amended to be in compliance.

Federal: Change or be Dissolved Automatically - The Federal Act takes a stronger approach. Federal NFPs will have to take steps to continue under the new Act. Federal NFPs that do not file Articles of Continuance under the new Act within three years of the Federal Act coming into force will be dissolved by Corporations Canada. The process of drafting, approving and finalizing Articles of Continuance will require federal NFPs wishing to do so to review and revise their by-laws and other constitutional documents to comply with the new Act.

Some Changes for New NFPs

Some important changes for new NFPs incorporating under the Federal Act and Ontario Act include:

- New NFPs will be able to incorporate as a matter of right without any approval or review of their constitutional documents simply by filing Articles of Incorporation, just as business corporations do.
- New NFPs will no longer require at least three incorporators. An NFP may be incorporated by one individual.
- While NFPs will still have to list their purpose, and can restrict their activities if they want to, acts taken outside those purposes are not invalidated; and NFPs will have all the capacity and powers of natural persons.

A Two-Tier Regime

Both the Federal Act and the Ontario Act contemplate a two-tier scheme for NFPs, separating those that bring in non-member donations, gifts or government assistance from those that don't.

This will subject charities and other NFPs that rely on third party money to a higher standard on some matters than NFPs that rely just on member donations or member dues for their income.

With respect to the upper tier:

- The Federal Act refers to “soliciting corporations”, which are NFPs that receive more than \$10,000 in non-member gifts, donations or government assistance during a three year fiscal period. Registered charities that do not meet this threshold are not covered by the definition of “soliciting corporation”.
- The Ontario Act uses the term “public benefits corporation”, which captures a similar threshold for non-member gifts, donations or government assistance, but all includes all registered charity NFPs regardless of non-member income level.

These upper tier NFPs have to meet requirements that the lesser tier NFPs do not, including:

- At least three directors, two of which cannot be officers or employees (federal).
- No more than one-third of directors can be employees of the NFP (Ontario).
- The members cannot restrict the management powers of the directors (federal).
- They face additional financial disclosure and reporting requirements (federal).
- They face stricter audit requirements (federal and Ontario).

- Upon winding up they must distribute their assets to qualified donees under the *Income Tax Act* (federal), or to charities or other NFPs as the case may be with similar purposes (Ontario).

Members and Their Rights

Both Acts make changes in terms of membership requirements, which is usually the trickiest issue to deal with when incorporating NFPs. The new legislation significantly expands the rights of members, and reduces the ability to have different classes of members with very different rights. Some key changes include:

- NFPs have to set out their membership classes and rights in their Articles.
- Directors do not have to be members unless the by-laws require it.
- Non-voting members have to be accorded a vote with respect to “fundamental changes” such as amalgamations, extraordinary transactions, changes in member classes, name changes, etc.; and they vote as a separate class.
- Members of NFP corporations will have the same rights to complain to a judge about “oppression” and unfairly prejudicial conduct as in for profit corporations, and courts will have very broad powers in dealing with those complaints.
- This broader oppression remedy will also be available to non-member parties that deal with the NFP.
- Members may have other rights similar to shareholder rights in for-profit companies e.g. a derivative actions remedy to commence litigation in the name of the NFP in circumstances where the board is refusing to do so but a judge believes it is in the best interest of the NFP for such a lawsuit to proceed (in the Federal Act only).

Directors, Officers and Their Obligations

The role and obligations of directors and officers of NFPs will also more closely mirror the role and obligations of directors and officers of for-profit corporations, including:

- Directors and officers will have a statutory duty of honesty and good faith and to act in the best interests of the NFP.
- Their standard of care will be objective, based upon the care, diligence and skill of a reasonably prudent person.
- Directors and officers will be excused from liability where they have exercised “reasonable diligence” based on an objective standard, and relied in good faith on professionally prepared

financial statements or the advice of an employee in reasonable circumstances or the report of an outside professional (e.g. accountant, engineer, lawyer, etc.).

Audit Requirements

Each Act has its own scheme for audit requirements.

The federal matrix takes into account the NFP's gross annual revenues and whether it solicits donations or not. Depending on the matrix and the wishes of the members a federal NFP (i) may not be required to have a public accountant at all, (ii) may only be required to have a public accountant prepare financial statements on a review engagement basis, or (iii) may be required to have a public accountant prepare audited financial statements.

The Ontario Act contains a similar matrix based on revenues (higher thresholds than the federal thresholds) and charitable status. But again, depending on where the NFP falls within the matrix and the wishes of the members an Ontario NFP (i) may not be required to have a public accountant at all, (ii) may only be required to have a public accountant prepare financial statements on a review engagement basis, or (iii) may be required to have a public accountant prepare audited financial statements.

Articles and By-laws

The Federal Act lays out a statutory scheme of (i) what must be included in the Articles; (ii) what must be included in the by-laws; and (iii) optional provisions that may be included in the by-laws. The Federal Act also permits everything that could be in the by-laws to be included in the Articles creating the possibility of an NFP having a single, comprehensive constitutional document.

The Ontario Act does not require the NFP to pass any by-laws. However, where an NFP does not pass by-laws within sixty days of incorporation it will be deemed to have passed the standard organizational by-laws provided for under the legislation.

Both the Federal Act and the Ontario Act permit the directors to pass by-laws that are effective immediately but have to then be ratified by the members, and permit members to propose by-laws that the NFP has to put to its directors and the membership.

As mentioned above, federal and Ontario NFPs will still have to list their purposes in their Articles, and can restrict their activities if they want to, but acts taken outside those purposes are not invalidated. NFPs will have all the capacity and powers of natural persons.

NFPs who wish to acquire or maintain charitable status from CRA will still need to carefully craft their Articles to satisfy CRA requirements. CRA's requirements for charitable status for *Income Tax Act* purposes are not changed by the Federal Act or the Ontario Act.

Concluding Thoughts

Increased board accountability is a common theme running through the changes made to both the federal and Ontario NFP schemes. These new regimes will more closely align not-for-profit governance with the corporate governance model of the for-profit sector. The increased rights accorded to NFP members will lead to some interesting challenges for some NFPs going forward.

In that regard, the ongoing problem of protecting the altruistic vision of the founders over the long run against the NFP being hijacked by a small or vocal group of people remains. The new legislation might help in some respects and hinder in others. As in the past, a well crafted constitution within the enabling legislative framework is an essential tool in risk managing an NFPs future.

However, we know that most NFPs have not taken a close look at their charter or by-laws for many years. The new legislation effectively requires every federal and Ontario NFP to revisit their constitutions over the next few years, which is an opportunity to modernize and update the NFP's governance model to meet its current practises and to strengthen the organization going forward. Overall, this will be a good thing for the sector.