# CORPORATE LAW REFORM AND CANADIAN NOT-FOR-PROFIT CORPORATIONS*

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*Introduction*

Most members of the legal profession are unfamiliar with the particular area of corporation law discussed in this paper. Therefore, the paper seeks to isolate and identify the important basic concepts and principles underlying this relatively esoteric area of corporation law, to provide an overview of the subject area and then provide suggested proposals for reform.

The paper deals primarily with corporations formed without share capital under Part II of the Canada Corporations Act, R.S.C. 1970, c. C-32, as amended by c. 10 (1st Supp.) hereinafter called the "present Act"). This paper will refer to the corporation so incorporated as the "not-for-profit corporation", for reasons to be discussed shortly. Companies with share capital incorporated under Part I of the present Act will be referred to as "business corporations" in keeping with the term suggested by Bill C-213 (the proposed "Canada Business Corporations Act") introduced for first reading in Parliament by the Honourable Herbert Gray, Minister of Consumer and Corporate Affairs, July 18, 1973.

This paper focuses primarily upon not-for-profit corporations incorporated at the federal level. The federal business corporations law is presently under reform (Bill C-213). In my opinion, in many respects Bill C-213 provides the most advanced statutory business corporation law of any jurisdiction in Canada. Thus it is appropriate to discuss not-for-profit corporations with a view to Bill C-213.

However, the approach of this paper is to attempt to identify and isolate those basic aspects of the not-for-profit corporation which necessitate unique statutory treatment. In my opinion, no jurisdiction in Canada at present has an adequate statutory law for not-for-profit corporations. This paper will deal with some of the unique aspects of the not-for-profit corporation due to its functional distinctiveness from the business corporation. These considerations are generally applicable to any jurisdiction in Canada which might undertake reform in respect to not-for-profit corporation law. No attempt is made to deal generally or comprehensively with all of the provisions necessary in a statute to deal adequately with these corporations. The emphasis is upon discussing the unique aspects of the not-for-profit corporation which necessitate unique statutory treatment.

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Subsection 154(1) of the present Act is the cornerstone provision for the federally incorporated not-for-profit corporation, requiring incorporation without share capital under Part II to be "without pecuniary gain to [the corporation's] members". This requirement may be otherwise expressed as stipulating that the corporation must be formed for a non-pecuniary purpose. This provision was first introduced to the federal corporation law by section 7A of the Companies Act Amending Act, 1917, with only minor amendments to date. Prior to section 7A of that Act a corporation without share capital could only be incorporated by Special Act. The first Act in which some of the provisions for not-for-profit corporations were isolated into a separate part was the 1952 Companies Act.

*General Criticisms of the Existing Federal Statutory Not-for-Profit Corporation Law*

There are many general criticisms which become apparent in a review of federal statutory not-for-profit corporation law.

First, there is an awkwardness in researching and referring to federal statutory not-for-profit corporation law through the basic approach of necessarily going to Part II of the present Act and then having to refer to the several sections of Part I which are made applicable to such corporations by subsection 157(1). Such an approach makes the statutory law applicable to not-for-profit corporations difficult to read and comprehend. It is difficult for someone referring to the statute to obtain an overview and to appreciate and grasp the inter-relationship of the various sections as made applicable to not-for-profit corporations.

Secondly, the approach utilized in making specific provisions of Part I of the present Act applicable to not-for-profit corporations creates difficulties because of the inappropriateness of the language of Part I which was drafted, necessarily, for the single purpose of being suitable for the business corporation, that is, the "company with share capital". This results in problems of interpretation in respect to the statutory law for the fundamentally different not-for-profit "corporation without share capital".

This approach results, on the one hand, in instances of statutory language which is entirely irrelevant but literally applicable to the not-for-profit corporation and, on the other hand, instances where there is an absence of the necessary language within those provisions of Part I made applicable to such corporations to make such applicability meaningful and effective. Both shortcomings result in a failure to accomplish apparent legislative intent. Subsection 157(1) does not even employ the phrase mutatis mutandis in seeking to make appropriate the language of Part I as applied to not-for-profit corporations (contrast subsection 157(1) with subsection 134(1) of The Corporations Act, R.S.O. 1970, c. 89, hereinafter referred to as the Ontario Act). The result of the legislative approach employed is that the

provisions of Part I made applicable to a not-for-profit corporation include words or phrases which are totally inappropriate because there cannot be any "partial deletion" or "partial amendment" of such provisions.

Thirdly, the present legislative approach has undoubtedly resulted in inherent limitations upon the development of appropriate statutory provisions for not-for-profit corporations. A basic approach of Part II of the present Act is provided through subsection 155(2) which requires the application for incorporation to be accompanied by the by-laws, in duplicate, which shall include provisions upon several essential matters. However, there is little in the way of general statutory provisions and standards as a background pertaining to such essential matters. This approach may be necessitated because many of the important provisions of Part I are thought to be sufficiently unsatisfactory in language and content for not-for-profit corporations and therefore are not made applicable to such corporations. However, Part II has not been sufficiently developed to include comprehensively the areas of coverage so omitted and therefore the Corporations Branch exercises a significant degree of continuing administrative control as to what is contained in the by-laws. The provisions with respect to directors are illustrative. Sections 86-92 and 94-97 are not made applicable to not-for-profit corporations. Undoubtedly the language thereof would have to be modified to make such provisions appropriate for such corporations. Nevertheless, the present legislative approach results in a virtual absence of general statutory provisions in respect to directors of not-for-profit corporations (for example, the equivalent of section 94 of the present Act for business corporations). There is simply incidental coverage on subsidiary matters (i.e. sections 93, 98 and 99). With this federal statutory approach, contrast the provisions in the Ontario Act which provide some general principles and standards pertaining to directors, for example, sections 130, 131, 313 to 320, subsection 321(1), sections 322, 324 and 328.

It may be that the main reason for the subsection 155(2) approach of the present Act is to meet the necessity of dealing with such gaps by requiring such matters to be dealt with in the by-laws and requiring the by-laws, in duplicate, to accompany the application for incorporation with ongoing supervision and regulation through proposed repeal or amendments of the by-laws being subject to the approval of the Minister. However, it is questionable whether this is a satisfactory approach. It is arguable that the absence of statutory standards results in a lesser knowledge and appreciation of duties, responsibilities, powers, etc. on the part of directors than would be so if there were statutory provisions present as enabling provisions and standards. It further results in an unnecessary expenditure of time and energy through the supervisory administrative role of the Department. It might also result in a tendency toward gaps in respect of suitable provisions and standards in by-laws, and lack of uniformity and inconsistencies as between not-for-profit corporations. For example, subsection 154(1) provides that the appli-

cants "become members of the corporation thereby created" and paragraph 155(1)(e) provides that the applicants "are to be the first directors of the corporation". However, there is no specific provision clearly requiring that directors other than the first directors be members. The only provision in this regard can be through the by-laws (see paragraph 155(2)(d)). Is the absence of a statutory provision requiring directors to be members a gap or is flexibility intended as a matter of policy? (Compare the federal statutory position for not-for-profit corporations with section 88 of the present Act for business corporations and with section 316 of the Ontario Act for Ontario corporations without share capital.) The subsection 155(2) approach tends to impede the development of general legal principles and standards and an understanding of those general principles and standards suitable for not-for-profit corporations.

Perhaps many of the possible problems of interpretation seem moot and not real and practical. However, they do suggest at the least potential problems; they do give rise to much unnecessary confusion; and they do indicate the unsuitability of the present statutory provisions as an administrative and legal framework for not-for-profit corporations. The present Act is not being functional for its intended purposes. Perhaps the reason for few real problems (if such be the case) is in part that the present Act is so awkward, confusing, and functionally unsuitable that there is lack of interest and desire to use the existing federal corporation law as a medium for incorporation of not-for-profit corporations. A better legislative approach would appear to be to have an independent statutory enactment applying only to not-for-profit corporations without share capital (either as a completely self-contained Part II with all of the provisions contained therein applicable to such corporations or, preferably, a completely separate statute for not-for-profit corporations).

*The Unique Characteristics of the Not-For-Profit Corporation*

The federal corporations which are the subject of discussion in this paper may be classified as those incorporated for a non-pecuniary purpose or, in the language of subsection 154(1) of the present Act, the corporation is formed for a "purpose . . . without pecuniary gain to its members". This type of corporation is most commonly referred to by the legal profession and laymen alike as a "non-profit corporation". However, the new term "not-for-profit" is employed in this paper as it is considered to be more accurate as well as more appropriate. The federal corporation formed for a non-pecuniary purpose is allowed to carry on lawfully a business incidental to such non-pecuniary purpose and hence a profit may result to the corporation. The corporation therefore is formed for a purpose which is "not-for-profit" to the members, but the corporation itself may earn a profit incidental to, and to further, its non-pecuniary purpose.

Therefore, implicit in the not-for-profit corporation is the single but fundamental limitation that it cannot be formed for the purpose of carrying on a business for a profit with a view to distribution or use of that profit for the pecuniary gain of its members. It must be formed for a non-pecuniary purpose.

It is evident that the not-for-profit corporation is opposite in purpose to the business corporation. The corporation formed for the purpose of carrying on a business has as its object the making of a profit for the pecuniary benefit of the shareholders. The business corporation has a pecuniary purpose and is accordingly formed with share capital as the corporate structure suitable to such purpose. The medium most suitable to the corporation formed for a non-pecuniary purpose is incorporation without share capital and this is the manner of incorporation provided under Part II of the present Act.

Not-for-profit corporations have received considerably less attention than the business corporation. This is readily evidenced by a significantly less developed statutory framework, very few judicial interpretations through the case law, little attention from the academic world and general disinterestedness on the part of the legal profession as a whole. This phenomenon is understandable as not-for-profit corporations are few in number, there is a lack of pecuniary interest and corresponding self-interest on the part of the membership, and much of the legal and accounting work for such corporations is done on a volunteer basis in the interest of service to the public. There is today, however, an increasing proliferation of not-for-profit corporations, probably due to several reasons, including the general growth in population, economy and wealth, and the tremendous expansion in governmental activity, particularly in the area of social and welfare services. Certain undertakings having a non-pecuniary purpose have today become so expansive that incorporation is often advantageous or necessary.[1] The total not-for-profit corporations incorporated simply at the federal level for the period 1900 to the end of 1970 numbered 1,502. Of this number, 522 were incorporated in 1966-1970. Of these, 253 were incorporated in 1969-1970. These figures do not include federally incorporated board of trade and chamber of commerce corporations (about 900), formed under the Boards of Trade Act, R.S.C. 1970, c. B-8, without share capital for the non-pecuniary purpose of promoting trade and commerce and thereby improving the economic, civil and social welfare of a given geographical area.

### *Advantages to the Not-For-Profit Corporation Being Incorporated Without Share Capital*

It is trite to state that incorporation often results in definite advantages over unincorporated groups conducting activities. What needs to be emphasized, however, is that certain corporate undertakings are best carried out by incorporating as a not-for-profit corporation without share capital. Part II of

the Canada Corporations Act provides the existing appropriate medium for incorporation of those organizations at the federal level which have in common the unique function of being formed for a non-pecuniary purpose.

If the incorporators wish to incorporate for a non-pecuniary purpose, it is appropriate to do so by the way of a statutory medium of incorporation which provides expressly for this distinctive and comparatively unusual corporate character so that the corporation's non-pecuniary purpose is enhanced and reinforced by a mandatory statutory basis (subsection 154(1) of the present Act) precluding pecuniary gain to the membership.

The non-pecuniary purpose of the corporation will be further reinforced by necessary detailed statutory provisions (assuming a comprehensive statute) which further the unique non-pecuniary purpose of the corporation. For example, one would expect regulatory provisions for the not-for-profit corporation pertaining to financial disclosure and distribution of surplus assets on dissolution. The distinctive features of the not-for-profit corporation will be aided by appropriate statutory provisions pertinent to such matters.

Furthermore, a comprehensive statutory framework will take into account the unique characteristics of the corporation formed for a non-pecuniary purpose by facilitating the structuring of the internal corporate organization. For example, membership in a not-for-profit corporation without share capital is usually made non-transferable, and accordingly is sometimes by statute presumptively non-transferable (for example, subsection 129(1) of the Ontario Act), so that membership lapses and ceases to exist upon the death of the member or, depending upon the by-laws, upon the non-payment of annual membership dues or other events. It is common for only a small percentage of the shareholders to take part in a business corporation's activities. Even though most of the shareholders of the business corporation are either disinterested or not locatable they must be treated as active shareholders and be sent required notices. This is expensive and inconvenient. Flexibility is needed for the not-for-profit corporation so that, when appropriate, notices can be dispensed with or given through local newspapers (see, for example, subsection 134(2) of the Ontario Act). Problems of control of a corporation can arise. There is no way to expel a shareholder of the business corporation whereas, if the by-laws expressly so provide, there can be expulsion of members of the not-for-profit corporation. The membership structure can have the common advantages of a share structure, such as classes of members and proxies. However, the not-for-profit corporation can dispense with many of the disadvantages of a business corporation. Membership in the not-for-profit corporation without share capital can be more easily limited to simply the active membership.[2]

Furthermore, those who wish to incorporate for a non-pecuniary purpose will often desire to facilitate the obtaining of resources and maximize the use of corporate resources for the corporate non-pecuniary purpose through a tax-exempt status for the corporation in respect to both its income and

property. It will also want donations to the corporation to be deductible from the taxable income of the donor or exempt from succession duties. Such tax-exempt or deductibility status can only be achieved if the criterion of the relevant taxation legislation is met. The relevant legislation in every Canadian jurisdiction requires of a corporation as a minimum for achieving such tax-exempt and deductibility status that it be formed for a non-pecuniary purpose. A further advantage of incorporation without share capital and providing a statutory basis for the non-pecuniary purpose of the corporation is that exemption from regulatory legislation, such as securities legislation, is more easily achieved. Once the designated medium of incorporation (Part II of the present Act) is chosen, statutory provisions restricting the corporation to a non-pecuniary purpose come into play. There is case law illustrative of the failure to achieve the necessary non-pecuniary status to meet the exemption requirements of taxation and securities legislation[3] through simply having restrictive provisions in the charter and by-laws, being the only basis available by which to seek non-pecuniary status once the medium of incorporation with share capital has been chosen. If a non-pecuniary purpose is truly desired for the corporation it is therefore advantageous to incorporate without share capital under Part II of the present Act.

*Necessary Prerequisites for a Statutory Framework for the Not-For-Profit Corporation because of the Unique Characteristic of being formed for a Non-Pecuniary Purpose*

The functional distinctiveness of not-for-profit corporations calls for legislative provisions appropriate to such corporations. When focus is placed upon the fundamental difference between a corporation formed for a non-pecuniary purpose as compared with one formed for a pecuniary purpose, it seems necessary and logical that the facilitating statutory framework for the not-for-profit corporation should provide appropriate provisions which restrict and regulate the withdrawal of monies connected with the corporation's activities. The enabling statute should do whatever is reasonably necessary to further the basic non-pecuniary purpose. For example, as has been mentioned, there should be appropriate statutory provisions pertinent to financial disclosure, directors' responsibilities and remuneration, and distribution of surplus assets upon dissolution. The enabling statute should also facilitate the unique requirements in respect to structuring of the internal corporate organization of the not-for-profit corporation.

The distinctive nature of the corporation formed for a non-pecuniary purpose also requires statutory language appropriate to such purpose i.e. non-commercial terminology. The statutory language generally employed for the business corporation is inappropriate for the functionally different not-for-profit corporation. This problem is compounded by the approach of the present Act which is to incorporate by reference provisions of Part I as being applicable to the Part II not-for-profit corporation.

Furthermore, relationships within the business corporation involving capital, management, directors, officers and employees do not normally vary with the different operations of various business corporations. Where they do vary, special statutes or statutory provisions have been enacted such as for banking, insurance, railway and public utility corporations. Special statutory provisions are also provided for the closely held business corporation. Subject to these qualifications, business corporations generally present the same problems for corporate law whatever the nature of the actual business operation. This is not so true in the case of not-for-profit corporations, the operations of which may vary considerably depending upon their objects. The functional differences of not-for-profit corporations create different problems for corporate law and call for different statutory treatment depending upon the particular type of not-for-profit corporation.

*The Two Basic Types of Not-For-Profit Corporations*

This paper considers that kind of corporation incorporated at the federal level solely for a non-pecuniary purpose. Not-for-profit corporations can and must, in turn, be divided into two basic types, depending upon the nature of their operations.

The first type is the corporation formed for a *public* non-pecuniary purpose which is more commonly referred to as the *charitable* not-for-profit corporation. Examples at the federal level would be the Salvation Army, the Red Cross Society, the Canadian Unicef Committee and Hockey Canada. The charitable corporation can be considered as one which meets the common law test as to what constitutes a charity set forth by Lord Macnaghten in *Pemsel v. Special Commissioners,* [1891] A.C. 531, 583:

> "Charity" in its legal sense comprises four principal divisions: the relief of poverty, the advancement of education, . . . the advancement of religion and . . . other purposes beneficial to the community not falling under any of the preceding heads.

Lord Macnaghten's definition (which is based upon the Statute of Charitable Uses of 1601, 43 Eliz., c. 4) is not, of course, nearly exhaustive as to the many specific activities which constitute recognized charitable activities. The courts continue to employ this definition and the specific divisions by analogy, albeit with limited success. It is impossible for a statute to set forth exhaustively all the possible charitable activities because they depend upon changing values. This question is best left for final determination in the event of a difference of opinion by the courts. The most a statute can do is set forth a list of specific, acceptable charitable activities, and include a definition of a general nature such as the last category in Lord Macnaghten's definition. A distinction is not made in the present Act between the charitable and the other basic type of not-for-profit corporation.

The other type of not-for-profit corporation is the corporation formed for a *private* non-pecuniary purpose such as social, fraternal, professional and the like. Activities for the benefit of the *membership* are the predominant aspect of the corporation although the corporation may sometimes extend incidentally some services of a charitable nature for the benefit of the public at large. This type of corporation can be referred to as the "membership corporation". Examples at the federal level would include the Scottish Rite and the Canadian Masonry Contractors' Association.

In the case of the charitable not-for-profit corporation the participants include many persons beyond simply the membership. The members themselves are really not present in a truly voluntary sense but rather because of the common belief that services provided by the corporation are essential to the well-being of society, that is, membership usually results through a compelling sense of public duty. The monies involved in the operations of a charitable corporation are usually substantial. There are donations received from many persons, commonly through solicitation. The activities and services of such corporations are also frequently subsidized by the taxpayer because of both tax-exempt status or deductibility status and also because of direct or indirect financial assistance by one or more levels of government. It must be further realized that, simply because charitable corporations provide services to the public, the taxpayer and public at large have a corresponding interest in the nature and quality of the services so provided. The taxpayer and others are therefore often present as the true participants in the charitable corporation and its activities, frequently without a voice or even knowledge. The charitable corporation is thus clearly formed for a *public* non-pecuniary purpose and operates in the public sector of society with the result that public concern about its activities is much greater than with the corporation formed for a *private* non-pecuniary purpose.

The foundation is a charitable corporation for it is formed for a public non-pecuniary purpose although it usually will have been created privately. The term "foundation" is not referred to expressly in legislation in Canada but is commonly spoken of without precise definition. The basic distinction between a foundation and any other charitable corporation appears to be twofold. First, with a foundation the funding usually arises through an initial or ongoing privately given non-solicited funding of monies to the corporation rather than through an ongoing continuous public solicitation of others for funds. Secondly, the foundation is usually non-operational in the sense of providing charitable services similar to that of an operating charitable corporation. The foundation's usual role is that of funding operating charities rather than itself providing such services. This suggested distinction between the operating charitable corporation and the non-operating one, the foundation, sometimes becomes blurred with a foundation which either may solicit or receive ongoing injections of monies, or may itself provide some charitable services through its staff. It is necessary, no matter what the activities of any

particular foundation, to appreciate that the enabling legislation, Part II of the present Act, affording incorporation without share capital allows incorporation through such medium because the foundation is being formed solely for a non-pecuniary purpose. Moreover, the stated purpose of incorporation is almost invariably a *charitable* non-pecuniary purpose.

The membership not-for-profit corporation is so called because the activities for the membership are the predominant aspect. This type of corporation therefore embraces all corporations without share capital formed for a non-pecuniary purpose other than charitable corporations. Membership in such a corporation is truly voluntary and for personal benefit although the benefit must necessarily be a non-pecuniary benefit. The impact of such corporations upon society at large is comparatively slight. Although some of these corporations may occasionally extend services of a charitable nature to the public and may also depend incidentally upon limited financial support from the public, the essence of such a corporation is that it is formed for a private non-pecuniary purpose and its operations are therefore within the private sector of society.

There is, therefore, a sliding scale of legitimate public interest in the not-for-profit corporation which depends upon whether the corporation is being formed for a *charitable* or a *private* non-pecuniary purpose.

*Consequences of being a Charitable or Membership Not-For-Profit Corporation*

The activities of the not-for-profit corporation may vary considerably, depending upon its objects. The statutory provisions for the corporation must on the one hand enable and on the other hand restrict depending upon the type of corporation under consideration. This is determined in large part by the activities carried out and the extent of public involvement which depends upon whether the corporation is being formed for a *charitable* or a *private* non-pecuniary purpose. With the corporation formed for a private non-pecuniary purpose membership is voluntary, incorporation is for the benefit of the membership, the money involved is relatively small and the impact upon the community is slight so that the members can be left for the most part to resolve their own problems. When we move to the charitable non-pecuniary purpose corporation the voluntary aspect grows considerably less, the participants being present often through necessity and a sense of public duty. The monies involved can be appreciable with donations from many persons including different levels of government, there is often solicitation of funds, and there is often subsidy through tax exemption. Further, the corporation is providing services to the public in respect to which the public therefore always has a corresponding interest simply because the services are in the public sector of society.

The reasons calling for different considerations in the legal framework for not-for-profit corporations as compared with other kinds of corporations, business or co-operative corporations, and between the two basic types of not-for-profit corporations, result from the unique character of such corporations because of their being formed for a non-pecuniary purpose. It is this fundamental characteristic which must underly all of the major considerations and features of the corporation law for not-for-profit corporations.

An evaluation of the legal framework for not-for-profit corporations therefore involves different considerations from those relevant to the business corporation for three reasons. First, there is a fundamental difference in purpose between a corporation formed for a non-pecuniary purpose as compared with one formed for a pecuniary purpose which calls for essentially different statutory provisions. Secondly, the uses to which not-for-profit corporations as a group are being put are considerably more varied than the uses for business corporations. Thirdly, the functional distinctiveness of the non-pecuniary purpose corporation calls for statutory language suitable to its unique, non-commercial, character.

It is also recognized that it is very desirable to have a single, unified, and consistent corporation law so far as possible for all corporations in any given jurisdiction. Therefore, this paper would propose unique statutory language and provisions are proposed only to the extent that the functional distinctiveness of the not-for-profit corporation necessitates such unique statutory language and provisions. Otherwise it is proposed that provisions of the statute pertinent to business corporations (Bill C-213 at the federal level) which are suitable for not-for-profit corporations as well as business corporations be enacted as provisions of a statute for not-for-profit corporations. However, all of the statutory provisions for the not-for-profit corporation should be contained within a "not-for-profit corporation" statute.

This paper emphasizes an analysis of the basic premises and policies to be considered in developing a statutory framework for the not-for-profit corporation because of the present uncertainty and lack of articulation in this regard (as compared with the business corporation) and because certain basic considerations necessarily and logically follow once such premises and policies are clearly understood. First, when focus is placed upon the inherent non-pecuniary purpose characteristic of the corporation under discussion it seems necessary to consider, as a logical and necessary consequence, appropriate statutory provisions which regulate the withdrawal of monies connected with the corporation's activities. The statute must do whatever is reasonably necessary to further its underlying policy enabling the existence of this unique corporate entity and must do whatever is essential to ensure and further the non-pecuniary purpose of such entity. Secondly, when it is realized that there are two fundamentally distinctive types of not-for-profit corporations it seems necessary to consider having very flexible enabling and restrictive provisions depending upon the type of

corporation (charitable or membership) under consideration. The needs of the corporation must determine the nature of the suggested statutory provisions.

*Incorporation*

Under subsection 154(1) of the present Act incorporation is by application for letters patent. The grant thereof is a discretionary exercise of the prerogative of the Crown not subject to scrutiny.[4] At first glance the merit of the discretionary grant of incorporation namely, that it provides an opportunity to control the character and quality of incorporations and thereby to protect the public interest, is particularly important in respect to not-for-profit corporations many of which are charitable in purpose and activities. In fact, most of the situations in which the withholding of the grant of letters patent has been considered have occurred in respect to applications under Part II of the present Act. The practice is to refer certain applications with particular objects to a given Department for approval. About 150 applications are so referred in any year, the majority of the references being to the Department of National Health and Welfare. For example, if the objects pertain to a "charity" the application would be referred to the Department of National Health and Welfare. If the objects pertain to "Indians or Eskimos" the application is referred to the Department of Indian Affairs and Northern Development.

However, there is no evidence that such discretionary power as a technique of incorporation is more successful in the desired objective of protecting the public interest than the technique of incorporation as a matter of right. From a practical standpoint, incorporation frustrated at the federal level is often simply diverted to a provincial jurisdiction. The present technique tends to cause delay and inconvenience, is costly, and imposes an impossible burden on the administrators of the legislation. The present technique may also hinder the furtherance of desired non-pecuniary purpose activities in society. Such activities can only be evaluated in a meaningful fashion through observation of the conduct and results of such activities. It is at this level that controls (largely absent at present) should be placed upon the not-for-profit corporation. The creation of not-for-profit corporations should not be restricted further than those (very few) restrictions placed by the law generally upon unincorporated not-for-profit associations.

The main argument for additional restrictions at the level of incorporation of the not-for-profit corporation appears to be that through incorporation there may be an appearance of government sanction for the not-for-profit enterprise which may solicit funds from the public. Paradoxically, it may well be that it is the present technique of incorporation through the exercise of a discretionary prerogative power that has the effect of giving a semblance of justification to the erroneous notion (if such exists at all) that because

an incorporated entity is soliciting, the government, through the Corporations Branch, has examined and approved the enterprise. In practice most donors, and virtually all donors giving any appreciable amounts, respond to solicitation on the basis of whether the gift is tax deductible. Thus the appearance of government sanction to the enterprise, with attendant credibility, comes through the actions of the administrators of the taxation legislation. The question of "tax deductibility status" is not, of course, determined simply on the basis of whether the solicitor of funds is incorporated.

Effective controls should, of course, be imposed upon the not-for-profit corporation's activities including solicitations. If this is accomplished, the probabilities are that the person desiring fraudulently to solicit funds will be discouraged from incorporating and thereby entering a much more comprehensive legal and administrative framework with attendant sanctions and penalties for improprieties.

Therefore, as with Bill C-213 for business corporations (sections 5, 7, 8), any proposed not-for-profit corporation statute should provide a change from the existing law by permitting incorporation generally as a matter of right (subject, of course, to compliance with the provisions of the statute). The traditional idea that limited liability is a privilege would remain true but, generally speaking, only in relation to post-incorporation conduct rather than to incorporation procedures.

*Capacity and Powers*

Part II of the *Canada Corporations Act* uses the term "corporation without share capital", the difference from the Part I company "with share capital" being obvious. However, the Part II corporation without share capital is commonly referred to as a "non-profit corporation" or "charitable corporation" possibly because these are the usual corporations without share capital and therefore most visible. These labels imply that the operations of such a corporation are not to result in a profit, that is, there must be expenses equal to or in excess of receipts so that no profit results. This erroneous understanding persists today. Although most not-for-profit corporations have the non-profit characteristic in their actual operations it is important to decide whether it is really the qualifying characteristic for incorporation. What is to be the range of permissible purposes for such a corporation? What is the desired legislative policy in allowing incorporation of not-for-profit corporations without share capital?

This question is posed because current trends in Canada suggest that the not-for-profit corporation is a vehicle of increasing practical importance and impact upon society. Furthermore, it is essential that the needs of the entity should determine the substance and form of the legislative and administrative framework and not the reverse. Although this question necessarily leads to consideration of the uses, both present and future, for

the corporation, this paper can only explore and hopefully stimulate in this regard rather than set forth a definite review of such uses.

It is useful to defer consideration as to the uses and needs of such corporations for the moment and first consider the possible legislative approaches as to permissible purposes for not-for-profit corporations as well as the approach of the present Act in this regard. The existing legislation in Canada and in the United States suggests that there are two approaches which may be adopted for permitting purposes for not-for-profit corporations, being the functional and economic approaches respectively.

With the functional approach, the activities in which the organization is engaged is the test. The functional approach sets forth those activities for which incorporation is permitted. Although a review of the legislation in Canada and the United States would reveal many stated permissible purposes it seems there are, generalizing, nine classifying categories: benevolent and charitable, social, recreational, trade and professional, educational, cultural, civic, religious, and scientific.[5]

The economic approach considers the economic relationship between the organization and its members as the test. The economic relationship between the corporation and its members becomes the crucial factor in determining the scope of the right to incorporation. This approach, by itself, would allow incorporation for any lawful purpose except those involving pecuniary gain to the members of the corporation. Any lawful purpose, so long as it is a non-pecuniary purpose, is a permissible purpose.

There are problems with each approach. With respect to the functional approach, the problems commonly confronted by such legislation are threefold in nature, namely, ambiguities in the language employed in defining permissible purposes, omissions in the list of permissible purposes, and the problem of changing permissible purposes to accord with changing social values as to what are desirable purposes for such entities.

*Permissible Corporate Purposes Under Part II of the Present Act*

Subsection 154(1) of the present Act is the enabling statutory provision for incorporation as a not-for-profit corporation. Incorporation is specifically qualified by the provision "for the purpose of carrying on, without pecuniary gain to its members, objects . . .". This requirement, constituting an economic approach is, of course, in recognition of the non-pecuniary purpose of the incorporation. It is coupled with what may be a functional approach through an enumeration of permissible purposes, the provision reading "objects . . . of a national, patriotic, religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character, or the like objects".

Several comments can be made. First, the legislative intent appears to be liberal in employing the economic approach. The only substantive limitation is upon the carrying out of the purposes that same be ". . . without pecuniary

gain to its members". This language taken by itself suggests that incorporation is permitted for any lawful purpose. Note that this would also include a *business purpose.* Incorporation is permitted as long as the basic purpose does not contemplate distribution of any earned profit to the members, that is, incorporation is sought for a non-pecuniary purpose.

This view is supported by the observation that section 16 (except paragraph (1)(r)) is made applicable to the corporation by paragraph 157(1)(b). Paragraph 16(1)(a) permits the corporation "to carry on any other business", which literally suggests that the corporation can carry on a "business" as its prime purpose, although the language of paragraph 16(1)(a) speaks of "other" before "business" because it has been drafted for the business corporation which would, of course, be carrying on a business as its purpose. The fact that paragraph 16(1)(a) is made applicable to the not-for-profit corporation suggests the legislative intent is to allow the not-for-profit corporation to carry on a business whereby a profit can be earned to further the fundamental non-pecuniary purposes. Compare the approach of the present Act with section 4 of the *Societies Act of Alberta*, R.S.A. 1970, c. 347, which allows incorporation ". . . but not for the purpose of carrying on a trade or business".

What is the purpose in specifically listing permitted objects in the present Act? They are very broad, particularly with the inclusion of the first object "national" and the concluding phrase "or the like objects". The legislative intent appears to be to simply list the objects as examples, enabling incorporation to take place subject to the necessary restriction that incorporation be for a non-pecuniary purpose.

Thus, it is arguable that the legislative intent of subsection 154(1) is simply to employ the economic approach as the criterion for incorporation. There is, however, an interpretation problem in the language used to impose this requirement, namely, as to what is meant by "pecuniary gain".

The problem implicit to the economic approach is that of achieving a precise definition for "without pecuniary gain" to members so that there is no room left for ambiguity. At least three possible interpretations can be given to the phrase in subsection 154(1) of the present Act "without pecuniary gain to its members". It may preclude any pecuniary benefit to members in any form whatsoever, which interpretation, for example, would preclude a trade association from being incorporated. Secondly, the words may be intended to preclude direct and indirect pecuniary gain, for example, by the corporation reducing prices for goods or services to its members (as with a co-operative association). Thirdly, the words may simply be intended to preclude the corporation from paying dividends or making a direct return on the investment of members. It is obvious that the first test is more stringent than the second, and the second more stringent than the third. In other words, the third test provides the narrowest view as to what constitutes a "pecuniary gain". The third test, i.e. the precluding of *direct* pecuniary

gains, means that no part of the assets, income or profit of the corporation can be distributable to or can enure to the benefit of the members, directors or officers of the corporation except to the extent permitted otherwise by the statute. The administration of the present Act suggests that the intention is to allow incorporation as a not-for-profit corporation as long as the third test is met, and as long as incorporation is not sought to achieve the indirect pecuniary gain of a co-operative association, incorporation of which is afforded through the *Canada Cooperative Associations Act*, S.C. 1970-71-72, c. 6. The incorporated cooperative association is not truly a not-for-profit corporation.

*The Proposed Scope for Incorporation of the Not-For-Profit Corporation*

If incorporation is sought for the purpose of carrying on a business so as to make a profit which is to be distributed to the shareholders the entity must be a business corporation with share capital. It is implicit to the Part II corporation without share capital that it cannot be formed for the purpose of carrying on a business for a profit with a view to distribution of that profit to its members. The corporation, by virtue of its inherent nature, has a prime purpose which is non-pecuniary in nature, hence it is to be formed without share capital as the appropriate structure to facilitate such purpose. A Part II corporation is inherently of a nature that it is formed for a non-pecuniary purpose. What must be decided is whether, given this inherent limitation, any lawful purpose (which would include any lawful business purpose, so long as the prime or ultimate purpose is non-pecuniary) should be permitted for such a corporation. There is general agreement that it is desirable for Parliament to authorize corporations to be formed for non-pecuniary purposes. The difficulty for Parliament is to decide upon the proper scope of the privilege of incorporation. Realizing that the necessary limitation for the Part II corporation must be that it cannot be formed for a pecuniary purpose, to what extent should there be any further limitation upon the privilege of incorporation?

This basic question necessitates a consideration of the relative merits of the functional and economic approaches. The answer must depend upon whether incorporation is to be regarded as a privilege to be accorded on the basis of the legislators' or administrator's notion of worthiness of the activity undertaken or whether it is to be regarded as a form of organization to be withheld only on the basis of policies which do not vary with the type of activity in which an unincorporated group engages or seeks to engage. Should incorporation be allowed to take place generally for any lawful, other than pecuniary, purpose?

We have seen that the one limitation inherent to the Part II corporation is that it must be formed for a non-pecuniary purpose. If it were otherwise, the entity sought by the incorporators must necessarily be the company with

share capital, so as to be able to distribute the profits as dividends or otherwise to shareholders to fulfil its pecuniary purpose. However, given this single inherent limitation, it does not necessarily follow that there must be any further limitation upon the scope of permissible purposes, or that the permissible purposes must be enumerated. The corporation should be able to carry on a business and earn a profit within its purposes as long as earning a profit is incidental to its fundamental non-pecuniary purpose.

If a statute adopts simply the economic approach a not-for-profit corporation can have as a purpose any lawful business or can exercise the power to carry on a lawful business activity, subject to the inherent non-pecuniary purpose limitation. If simply the economic approach is adopted, the descriptive phrase "non-profit" corporation is misleading, the more correct description being "not-for-profit" corporation. The corporation can earn a profit incidental to its fundamental purpose but cannot be formed simply to earn a profit. It cannot have as its fundamental purpose a pecuniary purpose because incorporation is only sought in such an instance when the objective is to distribute the profit earned to the members.

It must then be considered as to what interests can adversely be affected by allowing incorporation of a not-for-profit corporation for any lawful purpose. The two interested parties are creditors and the government through its interest in tax revenues. In respect to creditors, because the amount of capitalization required for the business corporation is insignificant, creditors are in no way prejudiced because of incorporation without share capital. In respect to the second interested party, the government, there is no automatic exemption in respect to taxation simply because of incorporation without share capital. The further possible concern that the not-for-profit corporation may provide unfair competition to the business corporation should only arise in deciding as to the merits of granting or maintaining a tax-exempt status. No attempt is made in this paper to suggest or definitively treat the tax status of not-for-profit corporations. Such status is of obvious importance. However, tax status should flow from the corporation's character and the manner in which it functions. The character of the corporation should not be determined by the tax legislation or tax policy considerations. Taxation of the not-for-profit corporation must be considered simply as a matter of tax policy which must take into account the merits of a privileged position for such corporations (or particular types thereof) because of their non-pecuniary purpose, and the concern about unfair competition resulting from any such privileged status conferred.[6]

At the present time not-for-profit corporations are formed to do what is essentially a business activity and others can and do incidentally carry on business activities although such activities are necessarily not for the purpose of making a profit for the pecuniary benefit of the members. A dramatic example in the public sphere would be the Canadian Film Development Corporation (R.S.C. 1970, c. C-8). Canada is experiencing an increasing

use of not-for-profit corporations formed for a business or near-business purpose, that is, a purpose which is commonly thought to be only a purpose for the business corporation formed to make a profit for the pecuniary benefit of its shareholders. A business activity therefore can either constitute or complement an important non-pecuniary purpose.

In considering the economic and functional approaches of existing legislation it is apparent therefore that it is really the economic approach which is fundamental to the not-for-profit corporation because of its inherent purpose and nature and although such corporations are commonly spoken of and conceptualized in terms of the functional approach such approach is unnecessary and undesirable to legislation enabling incorporation. The single, but essential, criterion to meet the requirements of enabling provisions of any new statute should be that incorporation is being sought for a non-pecuniary purpose. It may well be that the carrying on of a business should be a factor considered by tax legislation; however, such consideration should not preclude incorporation taking place.

The statutory provisions for not-for-profit corporations should simply set forth the requirements for incorporation. Incorporation would be required to be for a non-pecuniary purpose, that is, a purpose other than for the production of financial profit, gain or benefits for members, directors, officers or any other persons that might be associated with the corporation. No part of the assets, income or profit of the corporation could be distributable to or could enure to the benefit of the members, directors or officers of the corporation except to the extent permitted specifically by statute. Such approach would make it clear that the legislative intent is to allow incorporation for any lawful purpose, provided that the basic purpose of the corporation is not to make money, a non-pecuniary purpose being one to obtain a public or charitable benefit, or a non-financial benefit to a particular group of persons known as members. This suggestion is consistent with the provisions of the present Act, apparent existing legislative intent and policy, and the existing practice and activities of not-for-profit corporations. New statutory provisions are suggested and much more explicit provisions so as to better effectuate legislative policy, thereby rendering the enabling legislation more functional for both its intended purposes and the needs of not-for-profit organizations.

Therefore, a statute for not-for-profit corporations would abandon the traditional concept of corporate objects and powers. Not-for-profit corporations are and should be incorporated simply as a matter of course with unlimited objects, subject to the overriding requirement and limitation that incorporation is being sought for a non-pecuniary purpose. Not-for-profit corporations should be afforded the legal capacity of a natural person, similar to the capacity proposed by Bill C-213 (clauses 15, 16) for the business corporation. The corporation itself should decide whether it wants to restrict itself in the carrying on of activities or the powers it may exercise.

There should be, however, an explicit statement of the non-pecuniary purpose or purposes of the charitable corporation for several reasons. If a charitable corporation intends to solicit donations, a statement of the purpose for which the donation is requested is necessary and the use of the monies should be limited to the stated non-pecuniary purpose rather than any other, even non-pecuniary, purpose. Further, as public disclosure of the charitable corporation's activities and finances is necessary, an explicit statement of corporate purpose is essential to make such disclosure meaningful. Moreover, with the charitable corporation it is essential that the public (and government as surrogate on behalf of the public) as well as the members, have an explicit statement of the non-pecuniary purpose to evidence the purpose of the corporation and to evaluate and control the performance of the corporation and its directors and officers in fulfilling the assumed purpose or purposes. Therefore, there should be an explicit statement of the non-pecuniary purpose in respect to which incorporation is sought. However, the incorporators would determine that purpose or purposes and the corporation would have the legal capacity of a natural person to accomplish such purpose or purposes. Incorporation itself would generally be a matter of right. The charitable corporation would be restricted to carrying on only such stated non-pecuniary purpose or purposes but acts in violation of express restrictions in the articles of incorporation would not be invalid.

A not-for-profit corporations statute should provide for two types of not-for-profit corporations. The first is the "charitable corporation" being the corporation formed for a charitable (whether an operating charity or a charitable foundation) non-pecuniary purpose. The second is the "membership corporation" being intended to cover the usual membership type of corporation whose activities by or for members are the predominant aspect.

As the economic approach should be adopted by the statute it is necessary that a precise statutory definition be provided as to what is meant by "non-pecuniary purpose" or "without pecuniary gain". This would be required in any event even if the functional approach were to be employed as the non-pecuniary purpose restriction is always inherent to the kind of corporation under consideration. The definition should make it clear that what is intended is to preclude direct pecuniary gain and indirect pecuniary gain such as that derived through a cooperative association, incorporation of which is properly provided for by separate statute. The definition should make it clear that there is no intention to exclude from the benefits of incorporation those associations such as trade associations (many of which have been incorporated under Part II of the present Act) the activities of which may result directly or indirectly in intangible pecuniary benefit to the members.

As the economic approach is the inherent limitation which must necessarily govern incorporation there is need to employ statutory language setting forth precisely the limitation upon benefits to members, and this limitation must

allow for any desired exceptions (for example, remuneration to directors and members and distribution of surplus assets upon dissolution or surrender) and specify the permitted extent of any such exceptions. Two examples as to the confusing provisions of the present Act as to the extent of exceptions to the "without pecuniary gain" limitation of subsection 154(1) are illustrative of the need for express and clear statutory provisions in this regard.

For example, problems arise in construing the "without pecuniary gain" phrase in subsection 154(1) of the present Act in respect to remuneration of directors and members. Note that paragraph 155(2)(d) requires the by-laws to include any provisions in respect to the matter of remuneration of "directors, trustees, committees and officers". The unqualified "without pecuniary gain" statutory limitation imposed by subsection 154(1) suggests literally that any person in receipt of a salary from a corporation should not be a member. Further, the present Act is not explicit in requiring directors to be members. Subsection 154(1) provides that the applicants "become members of the corporation thereby created" and paragraph 155(1)(e) requires the applicants to be the first directors of the corporation. There is no specific provision clearly requiring that other than the first directors be members. This can, of course, be accomplished through the by-laws as permitted by paragraph 155(2)(d). Contrast this approach with subsection 316(1) of the Ontario Act which requires a director to be a member, and subsection 217(2) of the Ontario Act which qualifies the limitation upon the corporation that it be "without the purpose of gain for its members" imposed by subsection 127(1) by providing expressly in subsection 127(2) that both directors and members can receive reasonable remuneration and expenses for their services to the corporation.

A second example arises in the event of dissolution of the corporation. Can the surplus assets be distributed among the members and, if so, to what extent, or must the assets be donated to similar undertakings? On the one hand there is the "without pecuniary gain" language of subsection 154(1) of the present Act which limitation is included in the charter, but confusion is created by the inappropriate provisions from Part I, namely, paragraphs 16(1)(s), 32(1)(a), and section 33, made applicable to the Part II corporation. The result is that the answer to the question as to what happens to surplus assets upon dissolution is uncertain. In the absence of a restriction in the charter (a restriction being required to be included in the charter by administrative practice in respect of charitable corporations), upon dissolution of a not-for-profit corporation the members might claim to be entitled to their respective share of the assets. Clearly, this should not be permitted in respect to the charitable corporation. Straightforward statutory provisions are needed in this regard. The power to distribute among members upon dissolution should be limited by statute to the membership corporation.

Furthermore, although it is arguable because of the purposes permitted to the charitable not-for-profit corporation by its charter and the incidental

powers conferred by paragraph 16(1)(s) of the present Act that a charitable corporation can dispose of its assets upon dissolution to similar undertakings (or through the aid of the common law *cy près* doctrine), express statutory provisions should be provided in this regard. Assuming that upon dissolution there is a restriction upon distribution to the members, the present Act is very unclear as to what is to happen otherwise to the undistributed surplus assets. There should be clear statutory machinery determining where the undistributed surplus assets of the charitable corporation should go upon dissolution.

*Corporate Finance*

An important question is whether the common law characterizes a charitable corporation as a trust. Obviously any property received by a charitable corporation under a formal trust instrument will be held in trust. However, the case law in some jurisdictions suggests that even the unrestricted property of the corporation is subject to a trust.[7] What is the position in Canada? The question is important because it determines whether the provisions of the provincial Trustee Acts may be operative and whether the equitable *cy près* doctrine is applicable.

The problem is difficult to answer for several reasons. First, there is very little case law in Canada on the matter. However, the existing case law suggests that in Canada a charitable corporation is not *per se* a trust.[8] Secondly, the matter is not definitively settled in other jurisdictions. Thirdly, the notion of charity suggests implicitly notions of fiduciary duties in the layman's use of such terms, apart from whether legal and equitable principles are truly operative. Monies given to the charitable corporation, whether given directly or indirectly, in layman's language can be said to be given "in trust" to be used for a charitable purpose. There is always an expectation on the part of the public that the corporation will be held responsible for the use of such monies in accordance with the intended purpose similar to that responsibility commonly understood to be demanded of someone who is in law a trustee. Thus, subsection 1(2) of *The Charities Accounting Act*, R.S.O. 1970, c. 63, deems a charitable corporation to be a trustee within the meaning of that Act.

An *absolute* gift to a charitable corporation, a separate legal entity, which simply has as its object a charitable purpose should result in the corporation holding and administering that property with a clear legal title entirely free of trust law. The English and American cases dealing with the problem can arguably be rationalized on the basis that, because of the charitable non-pecuniary purpose of the charitable corporation, appropriate rules which are applicable to trustees will be employed by *analogy* to such a corporation in respect to their otherwise unrestricted property.[9] Thus, the courts of equity have historically exercised jurisdiction whenever the corporation's administration of the corporate property departs from its non-pecuniary

purpose so as to defeat the wishes of the "participants", members and otherwise, of such a corporation.[10] As early as 1601, by the Statute of Charitable Uses, the Chancellor was authorized to investigate the abuses, breaches of trust and mismanagement of property given for charitable uses.

The above discussion suggests that it should be made clear by statutory provision that an *absolute gift* to a charitable corporation results in the corporation holding and administering the property received entirely free of trust law and the operation of provincial Trustee Acts. This would clarify the common law and give certainty that the preferred view of the common law position is operative.

The next question then is: should the investments of charitable corporations, in respect to property received free of trust law and the application of any provincial Trustee Act, be restricted in any way? Canadian corporations statutes do not place restrictions upon the type of investments of charitable corporations (although section 2 of *The Charitable Gifts Act* of Ontario, R.S.O. 1970, c. 61, limits the extent of investments to not more than a 10% interest in a business). Other jurisdictions expressly permit unrestricted investments.[11] Perhaps, at the least, the charitable corporation should be limited to trustee-type investments (perhaps those permitted under subparagraphs 64(1)(a)(i), (ii), and (iii) of the *Trust Companies Act*, R.S.C. 1970, c. T-16) unless the articles otherwise provide. Subsection 11(3) of the British Columbia *Societies Act*, R.S.B.C. 1960, c. 362, takes this approach.

A not-for-profit corporations statute should provide that "any profits or other accretions" shall be used in furthering the corporate non-pecuniary purpose. Such a cornerstone provision would express the essential limitations upon the administration of the corporate property of the not-for-profit corporation.[12] As there are, of course, many ways apart from a direct distribution of "dividends", in which members (like shareholders) might arguably receive a pecuniary gain from the corporation if it were not for express statutory prohibition, the statute should impose a blanket prohibition upon "the assets, income or profit" of the corporation being a pecuniary benefit to members or directors, with only specific, stated, exceptions to this blanket prohibition being permitted.

For example, "reasonable" remuneration to directors and member employees is a desirable, justifiable, and necessary exception to the general limitations upon pecuniary gain to directors and members.

There must be limitations upon the remuneration of directors and member employees. This could be provided by the limitation that the remuneration be "reasonable". Beyond this, public disclosure should be required of the charitable corporation and appropriate statutory remedies should be available to prevent or rectify abuse.

*Directors and Officers*

The present Act is deficient in providing appropriate statutory provisions with respect to directors and officers for not-for-profit corporations. This may be because the provisions of Part I applicable to the business corporation are so unsatisfactory in language and content for not-for-profit corporations that they are not made applicable through section 157. However, Part II has not been sufficiently developed to provide comprehensively for this subject area. Sections 86-92 and 94-97 of the present Act are not made applicable to not-for-profit corporations. There is simply incidental coverage on subsidiary matters (sections 93, 98 and 99). The present approach results in a virtual absence of essential provisions and general standards for the not-for-profit corporation. This approach also imposes upon the Corporations Branch the task, difficult to fulfil adequately, of exercising a significant degree of continuing administrative control over what is contained in the by-laws. There is also an unnecessary expenditure of time and energy through this supervisory administrative role.[13] The absence of statutory standards results in a lesser knowledge and appreciation of duties, responsibilities and powers on the part of directors and members than would be so if there were comprehensive statutory provisions. There is a resulting uncertainty by the corporation, its directors, officers and members as to capacity and locus for the exercise of power within the corporate structure and the imposition of responsibility for corporate decision-making and actions. There is need for express statutory provisions in respect of such matters.

The standards of care, loyalty and good faith for directors of business corporations have received much discussion in connection with statutory reform for business corporations. Members of a not-for-profit corporation, lacking the pecuniary interest and resulting motivation of immediate self-interest of shareholders of a business corporation, are generally content to leave the management of the affairs of the corporation exclusively to the board of directors. This suggests an argument for a standard of care higher than for the directors of a business corporation so as to provide an additional safeguard to offset the indifference of the members. It can be argued further that the duty of care of a director in a charitable corporation should be higher than in a business corporation because it is *analogous* to a trustee's duty on the basis that the assets of the corporation come in many cases from public solicitations, contributions, or through tax exemption, and therefore are closer to a trust *res* than ordinary business corporation capital.

On the other hand, directors of charitable corporations usually serve because of a sense of public service and as representatives of the community at large. They usually do so without remuneration, indeed often at considerable personal sacrifice. They are seldom able to spend sufficient time to become familiar with the details of the corporation's operations. They are

often prominent citizens in the community, bringing substantial skills to the board of directors (for example, successful management expertise, fund-raising skills, public relations know-how, and professional skills such as accountancy or legal) and they attend meetings simply in an advisory and supervisory capacity. Many do so with little appreciation of the corporation's particular problems, other than those problems which relate to their particular skills from time to time. As the director of the charitable corporation serves from a sense of public duty rather than self-interest, he cannot be expected to devote as much attention and time tc the corporate affairs as he would if he had a proprietary interest. The argument can be made that the duty of care of such director should be less exacting than the director of the business corporation so as not to discourage public-spirited citizens from assuming such a role. The argument follows that, if the director is simply one whose role is supervisory, the standard of care employed should be the degree of care of a reasonable person *in comparable circumstances.*[14]

The formulation by these statutory provisions of the general duty of care, diligence and skill owed by directors represents an attempt to upgrade the standard otherwise required of them by the common law. The principal change is that, whereas the common law provides that a director is only required to demonstrate the degree of care, skill and diligence that could reasonably be expected from him having regard to his knowledge and experience,[15] under the mentioned provisions he is required to conform to the standard of a reasonably prudent person. Thus the new statutory provisions somewhat raise the common law standard which employs a fairly subjective test. However, the common law "reasonable man" test is a juristic construct, that is, the court is the "reasonable man" and the "reasonably prudent person" test will be applied by the same courts. Therefore, considerable scope for discretion remains in applying the test. The common law experience in respect of business corporations has demonstrated a low legal standard of care for directors and these provisions seek to raise it. The argument can be made that raising the standard of conduct for directors may deter people from accepting directorships. However, the members of the not-for-profit corporation should be able to have the confidence that the activities of the corporation are being managed by competent persons held properly accountable. There is also considerable merit in having a consistent, single, well-understood corporation law in the area of directors' duties. Therefore, the same standard should govern the director of the not-for-profit corporation as that which governs the director of the business corporation.

*Financial Disclosure*

The present Act says very little about the form and content of financial statements or financial disclosure in respect of not-for-profit corporations. The provisions applicable are sections 117, 130, 131, 132. Section 117 makes mandatory the keeping of "proper accounting records" and sections

130 and 131 pertain to the appointment of the auditor. Section 132 sets forth the requirements of "an audit" and "auditor's report" which is to be based on "the financial statement". However, section 132 does not specify the nature of the "financial statement" required for the not-for-profit corporation.

The present Act has extensive provisions for business corporations in respect of financial reporting and disclosure. These provisions are inappropriate for the not-for-profit corporation because of its non-commercial nature. For example, section 118 of the present Act requires the directors of the business corporation to place before the annual meeting a "comparative financial statement" made up of an "income" statement, a statement of "surplus", etc. The terms used necessarily have simply a commercial connotation. This language is unsuitable for the not-for-profit corporation because of its functional distinctiveness from the business corporation. Perhaps it is because of this unsuitability of language that section 118 is not made applicable to Part II corporations. However, there is no parallel provision in Part II of the present Act.

Moreover, because not-for-profit corporations are put to more varied use than business corporations there is need for statutory treatment which is flexible depending upon the activities of the particular type of not-for-profit corporation.

The form and content of the financial statements for the not-for-profit corporation should be prescribed by regulation. This is the approach adopted for business corporations by Bill C-213 (clause 146) and it is even more appropriate for not-for-profit corporations. This would be done only after previous exposure to the accounting profession and interested groups. This could be accomplished by the regulations not being effective until at least sixty days after their publication (subclause 251(2) of Bill C-231). Moreover, the recently enacted *Statutory Instruments Act*, S.C. 1970-71-72, c. 182, provides controls upon delegated legislation. A right would also be provided to apply to the court for an exemption from any of the rules laid down in the regulations in respect to the form and content of financial statements.

The need for improvement in the quantity and quality of financial disclosure required of not-for-profit corporations can be best accomplished through this approach. First, accounting practices are always evolving and the legal framework needs to be flexible and adaptable. Secondly, there are two very different, basic types of not-for-profit corporations, and within each basic type widely varying operations, which call for a responsive and flexible form of legislation.

From the standpoint of present practice, the general principles set forth in the *Canadian Standards of Accounting and Financial Reporting for Voluntary Organizations*, Report of Steering Committee of the Canadian Institute of Chartered Accountants *et al;* 1967, are often followed by the auditors of

not-for-profit corporations. The compilation of *Canadian Standards of Accounting and Financial Reporting for Voluntary Organizations* was thought necessary in part because of the need for appropriate standards for the not-for-profit corporation, the present absence of meaningful statutory standards, and the different, non-commercial terminology and criteria, as compared with business corporations, considered to be appropriate for not-for-profit corporations.

General standards would be set forth in the regulations in the nature of those suggested in *Canadian Standards of Accounting and Financial Reporting for Voluntary Organizations* such as in respect to the accrual basis of accounting, fund accounting, comparative figures, an analysis of expenses on a functional basis, a summary of financial activity, statements of changes, etc. This approach would not only bring extensive reform in respect of quantity but would also bring *uniformity* in respect of the form and structure of financial statements. This is essential to realization of the goal of meaningful disclosure to the public of the activities of charitable corporations.

There must be adequate reporting provisions to afford both the government and the public disclosure of the charitable corporation's financial affairs and its administration and operations. Reporting provisions would require initial and annual returns, or more often if so requested by the appropriate government officials. The form of such returns can be determined by regulations modified as necessary from time to time but would include such matters as: the financial statements with all necessary supplementary explanatory information, the auditor's certification of the financial statements, names and addresses of the directors and officers, and remuneration paid to them, information as to tax-exempt status, details about the nature of monies raised through solicitations (but not the names of contributors), names and addresses of professional fund raisers, particulars of contracts with professional fund raisers, details of the nature of operations so as to reveal whether there is self-dealing, etc. and particulars of the property of the corporation, including details as to transactions during the period reported. Prompt notification should be required of the corporation as to significant changes in information required to be furnished in the annual return (for example, a new professional fund raiser's contract, or new fund-raising campaign, or loss of tax-exempt status).

Although little is required by the present Act, in practice most not-for-profit corporations do, of course, follow accounting procedures necessary and appropriate to their operations. The imposition of generally accepted accounting standards through prescribed regulations of a new statute would not result in either hardship or expense for the vast majority of not-for-profit corporations. For example, the United Funds in Canada require of their member organizations compliance with the major proposals being advanced. The appropriate accounting standards benefit the corporation itself, of course, through assisting in planning and control. The proposed framework would provide, through saving and exception provisions, sufficient flexibility to

prevent hardship and cost. Therefore, the requirements of financial disclosure for the not-for-profit corporation would result, without significant cost, in greater safeguards to the corporation, members, and the public, from the potential harm and much greater cost which may occur through unrecognized abuse of the non-pecuniary purpose of the corporation.

The next consideration is the need for financial disclosure. The policy underlying the *Income Tax Act* is that the privilege of an exemption of otherwise taxable income is desirable to facilitate the non-pecuniary purposes of charitable corporations. As the loss of tax revenues must be made up from taxpaying sources, the taxpaying public is subsidizing the services provided by charitable corporations. A charitable gift is also underwritten by the public to the extent that the cost of the gift to the donor is reduced by the allowance of an income tax deduction (or succession duty exemption). Therefore, the public has the corresponding right to evaluate the performance of "tax-exempt" corporations in providing such services similar to the evaluation afforded in respect to the use of other public monies. A policing function to prevent tax evasion is performed vicariously by the Department of National Revenue. However, this policing function is limited simply to establishing that the monies involved in the operation of the not-for-profit corporation are being channelled into services which the corporation is to provide. This policing function would be facilitated incidentally through the requirement of public disclosure in respect of the corporation's activities, financial statements, etc.

The question arises as to the extent to which the supervision of charitable corporations is, or should be, undertaken by the Department of National Revenue. Clearly, the primary function of that Department is to produce revenues through enforcement of the *Income Tax Act*. However, most of the usual problems of the charitable corporation are not of importance to the Department of National Revenue, for example, problems such as investment policy, inefficient or inactive management, the quality of services provided, and the efficient utilization of monies and property. The sanctions imposed by the *Income Tax Act* do not tend to promote the public interest in respect of these concerns.

Many jurisdictions (for example, England and in the United States) divide the function of supervision and enforcement between the taxation authorities and another government agency. It is necessary, of course, that the appropriate balance between the two agencies be considered and that there be the fullest co-operation so that the overall objectives of the government and the public in supervision and enforcement are best achieved.

The provisions of any new statute for not-for-profit corporations should not be suggested for reasons of tax policy. Such concerns are properly left solely to tax legislation. New statutory provisions are necessary simply because the goals of tax legislation are not coincidental even though they are to some extent complementary.

What should be the concern of the not-for-profit corporation, its members,

the public, and the government in respect to financial disclosure? Implicit to the idea of "charitable" is the notion of "trust", apart from the question as to what extent actual legal or equitable principles of law come into play. Monies are given to the charitable corporation in the layman's sense of being "in trust" to be used for the given charitable purpose. There is an expectation on the part of the public that the corporation will be held responsible for the use of such monies in accordance with the intended charitable purpose. Furthermore, the members and directors of the charitable corporation are not motivated by a pecuniary self-interest. There are not the built-in incentives on the part of the members and directors to maintain interest and control as in the business corporation.

The two basic types of not-for-profit corporations depend upon the extent of public involvement. In respect to the membership corporation formed for a private non-pecuniary purpose, the membership is voluntary, the impact on the community is slight, and the monies involved relatively insignificant so that the members can be left for the most part to work out their own problems. Therefore, flexibility is needed through saving and exception provisions to minimize the regulatory control in respect to membership corporations.

Public involvement is significantly greater in the case of the charitable corporation. Donations are made by many persons, for the most part from beyond the membership, and services are provided by the corporation to the public. Several hundred million dollars are involved annually. For example, the amount of money deducted for tax purposes for 1970 for donations to charities by individuals alone amounted to over one-quarter billion dollars.[16] Society has an interest in seeing that the services are satisfactorily provided. The real investors are often the taxpayers, present without choice or knowledge. Some charitable corporations are financed by monies flowing through the Canada Assistance Plan or otherwise by the federal governments. The projected expenditures to the provinces for 1972-73 under the Canada Assistance Plan amount to almost one-half billion dollars.[17] The voluntary aspect of the charitable corportion is minimal. The public concern is paramount.

When the foundation is considered in relation to its stated charitable non-pecuniary purpose, adequate disclosure is both a logical and necessary consequence. Lack of direct contact with the public does not mean that the foundation should be any less exempt from public scrutiny than the operating charitable corporation providing services directly to the public.

Disclosure and policing mechanisms encourage the proper channelling by foundations of their resources and provide a better basis for the public to identify problems that might exist. It is difficult at present to establish the extent of the phenomenon of the foundation in Canada or the possible problems in respect thereof because there is no central source to afford meaningful data.

There are some 1,400 foundations in Canada[18] and these can be classified

into five broad categories: general charitable purpose, particular charitable purpose, business corporation sponsored, family controlled, and foundations which confine their interest to a given geographical area or community. The fact that a foundation depends upon private initiative for its creation, funding and ongoing activities does not mean that financial disclosure should not be made to the public. The foundation is incorporated for a charitable non-pecuniary purpose. The element of personal control possible in the foundation and personal interest in respect of the foundation's property may sometimes be conducive to under-recognition of the stated charitable non-pecuniary purpose of the corporation. Furthermore, tax privileges are almost always sought by the foundation and its donor, with the result that the public, through the taxpayer, is a participant in the foundation.

There is a common need by fund raisers and operating charitable corporations and organizations to know what is happening and what is available in the way of funds from foundations. With effective disclosure, foundations are also more likely to know what other foundations are doing so as to better co-ordinate and not duplicate their respective programs and so as to better develop a common and mutually advantageous professional and administrative expertise. The effectiveness of foundation planning, administration and giving of funds is impeded by the lack of communication amongst foundations themselves.

The considerations advanced for disclosure to the public extend to the operating charitable corporation or foundation which does not solicit donations through public subscription (either by membership fee or donations from non-members, or both) or seek tax-exempt or deductibility-for-donor status, simply because the stated purpose of the corporation is to provide services, directly or indirectly, in areas of recognized public need. The public should be able to ascertain whether and what services are being provided and the quality thereof. This information will tend to enhance the nature and quality of the services of such corporations through corporate awareness that the information is available to the public and will provide a basis for private or public initiative when the quality of services is considered to be inadequate.

The charitable corporation is a suitable mechanism to utilize individual initiative in meeting certain social needs with a minimum of government participation. The public has the right to assess the performance of charitable corporations. Disclosure also increases the likelihood of retention of the present system of extensive private activity in the charitable activities field. Activities are less likely to be unwittingly assumed by unnecessary government programs.

A more informed response can be made to a solicitation if information is available setting forth clearly the cost of administrative overhead, etc. For example, the Better Business Bureau, in responding to inquiries about solicitations by charitable organizations, often employs the standard of de-

termining the percentage of monies expended in administration as compared with operations. However, even this simple and rough yardstick is difficult to use because of the lack of required disclosure and the lack of uniformity in the form of disclosure voluntarily made.

A simplified and less costly approach to public disclosure would be to marry the reporting requirements under any new not-for-profit corporations statute with those required under the *Income Tax Act,* utilizing a return with a "confidential" portion (which would include, for example, any reference to the names of contributors) and a "public" portion. A copy of the entire return would go to the taxation authorities with a copy of the "public" portion being utilized for the purpose of the corporations statute. Disclosure of the "public portion" could be extended, of course, as in the United States, to all charitable organizations (thereby including provincially incorporated corporations and unincorporated associations) filing returns under the *Income Tax Act* through the tax legislation itself requiring public disclosure thereof.

*Liquidation and Dissolution*

The law of dissolution for not-for-profit corporations, as with business corporations, is in a chaotic state. Sections 31 to 33 of the present Act permit voluntary dissolution and sections 5-6 and subsections 133(11) and 150(1) authorize the dissolution or winding-up of not-for-profit corporations which have acted outside the scope of their objects or powers or which have failed to comply with certain provisions of the Act. There is some uncertainty as to whether the *Bankruptcy Act* applies to an insolvent not-for-profit corporation[19] although this appears to be an assumption which has been acted upon. It seems also to have been the intention of the draftsman of the *Bankruptcy Act* as not-for-profit corporations are not expressly excluded from the definition of "corporation" and not-for-profit organizations are included within the definition of "debtor" and "person" in section 2.[20] The *Winding-up Act* applies to federally incorporated not-for-profit corporations in situations both of solvency and insolvency, although, under the 1966 amendments to the *Bankruptcy Act,* that Act (if it applies to not-for-profit corporations) can be used to oust the jurisdiction of the *Winding-up Act* where the corporation concerned is insolvent. Therefore, new statutory rules to clarify the rules applicable to corporate dissolution are desirable, except where the corporation is insolvent. Insolvency should be dealt with in the *Bankruptcy Act.* Generally, these required new provisions could be adapted from those applicable to business corporations (Part XVII of Bill C-213).

However, because of the unique nature of the not-for-profit corporation, some special provisions are necessary. The present Act is unclear, as already discussed, as to what happens to surplus assets upon dissolution. A federally incorporated not-for-profit corporation would be wound up under the

*Winding-up Act*. However, that Act has no special provisions for not-for-profit corporations and is generally inappropriate.

Administrative practice for the last several years under the present Act (and similarly under the Ontario Act) has been to require a provision to be included in the charter requiring disposal of the charitable corporation's assets on dissolution or surrender to be in a manner which will not result in a distribution to members. Surprisingly, none of the Corporations Acts or Societies Acts in Canada provide a clear framework in respect to this matter for charitable corporations.[21]

In the absence of a statutory provision, if there is not a provision in the charter, the common law is unclear as to what happens to the surplus assets of a charitable corporation on dissolution. It seems that there may be three possibilities.

First, the court may find an implied condition that the assets of the corporation were not received from a donor with a general intention in favour of a charitable purpose. Hence, they may be required to be returned to the donor.[22] The second possibility is that the Crown may be able to claim the property of a corporation upon the winding-up of its affairs on the principle of *bona vacantia*.[23] The third possibility is that the *cy près* doctrine will be applicable.[24] Charitable corporations commonly receive donations from donors who do not have any intention of making a gift to the members individually. When literal effect cannot be given to the donor's intention because of the dissolution of the donee, and the donor had a general intention in favour of a charitable purpose, the intention of the donor should govern as nearly as possible. The legal rule to this effect is called the *cy près* doctrine and is based upon the analogy of the charitable corporation to a trust.[25]

A statutory *cy près* rule is needed for the charitable corporation. This is the modern approach adopted in several American jurisdictions.[26] The statute should require the corporation to adopt, by special resolution, a plan of distribution as to where the assets will go upon dissolution and this must be within a *cy près* context. In the event that a plan of distribution is not so adopted, the statute should require the liquidator to adopt a plan of distribution which meets the *cy près* requirement. Court approval of the plan of distribution would be required, and the Registrar (surrogate for the public interest) would receive notice and be able to appear before the court.

The present Act does not seem to impose any limitations upon the distribution of surplus assets accompanying the dissolution of a not-for-profit corporation formed for a private non-pecuniary purpose (i.e. a membership corporation). Historically, there is some suggestion at common law that the assets may be escheated to the State.[27] Although the position at common law is unclear, the weight of authority seems to be that there is not any restriction upon distribution to the member in the absence of a statutory restriction.[28] Occasionally these assets can be very substantial. None of the

jurisdictions examined place any statutory restrictions upon membership corporations in respect to this matter. Many jurisdictions have statutory provisions which expressly permit the distribution of surplus assets upon dissolution to the members of a membership corporation.[29]

The statute should provide for a distribution of any surplus to the members of a membership corporation in the absence of a charter provision or by-law to the contrary. The by-laws of a corporation formed for a private non-pecuniary purpose could stipulate, of course, that any surplus is to go upon dissolution to another corporation or organization with similar objects or otherwise than to the members.

*Summary*

The functional distinctiveness of the not-for-profit corporation calls for unique statutory treatment. An examination of the federal statutory corporation law indicates the need for a new, separate "not-for-profit corporations" statute. Appropriate provisions would cover the particular needs of this unique entity. There would be a departure from the statutory provisions applicable to business corporations (Bill C-213) only to the extent necessary due to the functional distinctiveness of the not-for-profit corporation and due to the need for appropriate, non-commercial terminology.

Although the focus of this paper has been upon the federal not-for-profit corporation, the premises and policy considerations discussed are appropriate to any jurisdiction in Canada contemplating reform in this particular area of corporate law.

## FOOTNOTES

1. See generally Lesher, "The Non-Profit Corporation—A Neglected Stepchild Comes of Age", (1967), 22 Business Lawyer 951, which provides an insightful appreciation of the underlying premises in respect to not-for-profit corporations, and is the origin of several of the ideas expressed in this paper.)
2. See generally Cudney, "Corporations Without Share Capital", [1951] Can. Bar Rev. 846.
3. See, for example, *St. Catharines Flying Training School Ltd.* v. *M.N.R.*, [1953] C.T.C. 362, 369, and *In the Matter of Hawkesbury Golf & Curling Club,* [1968] O.S.C.B. 161 (July 1968).
4. *Bonanza Creek Mining Co. Ltd.* v. *The King,* [1916] 1 A.C. 566; *Poizer* v. *Ward,* [1947] 2 W.W.R. 193; *Re Cole's Sporting Goods Ltd.,* [1965] 2 O.R. 243.
5. See generally "Permissible Purposes for Non-Profit Corporations" (1951) 51 Colum. Law Rev. 889, and "Non-Profit Corporations—Definition" (1963), 17 Vand. Law Rev. 336.

6. See, generally, the *Report of the Royal Commission on Taxation,* Vol. 4, pp. 128-41.
7. See, for example, *Re Manchester Royal Infirmary* v. *Attorney-General* (1890), 43 Ch. D. 420, 428, and *Royal College of Surgeons of England* v. *National Prov. Bank Ltd.,* [1952] A.C. 631, 634, 662-663, and, generally, Mockler, "Charitable Corporations: A Bastard Legal Form", 1966 Can. Bar Assoc. Papers, pp. 231-3.
8. See *Roman Catholic Archiepiscopal Corp. of Winnipeg* v. *Ryan* (1958), 12 D.L.R. (2d) 23, 24 (B.C.C.A.), and *Re Schechter* (1964), 43 D.L.R. (2d) 417, 426, 427 (B.C.C.A.), affirmed (1966), 53 D.L.R. (2d) 577, 580 (S.C.C.).
9. See Scott, *The Law of Trusts* (3rd ed.), Vol. IV, pp. 2770-80; but see *Tudor on Charities* (6th ed.), p. 318.
10. See, for example, the cases referred to by Scott (*supra*).
11. See, for example, section 512 of the New York Not-for-Profit Corporation Law, Laws 1969, c. 1066, as amended.
12. See, for example, subsection 154(1) of the present Act, section 127 of the Ontario Act, sections 204 and 508 of the New York Not-for-Profit Corporation Law, and paragraph 2(c) and section 4 of the Model Non-Profit Corporations Act.
13. In contrast, the Ontario Act has extensive provisions in this area through sections 130, 131, 313 to 320, subsection 321(1), sections 322, 324 and 328.
14. See clause 114 of Bill C-213, section 144 of *The Business Corporations Act* (Ontario), and section 7.17 of the New York Not-for-Profit Corporation Law to the same effect.
15. *Re City Equitable Fire Insurance Co.,* [1925] Ch. 425.
16. See Taxation Statistics, Information Canada, 1972.
17. See "How Your Tax Dollar is Spent", Treasury Board, Information Canada, 1972, at p. 22.
18. See *Financial Post,* May 8, 1971, p. 11.
19. See the somewhat limited definition of "corporation" provided by section 2 of the *Bankruptcy Act.*
20. See the decision of the Quebec Court of Appeal in *Chausse* v. *L'Association du Bien-Etre de la Jeunesse Inc.,* [1960] B.R. 413, in which it was held by the majority that a not-for-profit corporation incorporated under the Quebec *Companies Act* was not a corporation governed by the provisions of the *Bankruptcy Act.*
21. See, for example, *Guaranty Trust Co. of Canada* v. *M.N.R.* [1967] S.C.R. 133; [1966] C.T.C. 755, and *Re Windsor Medical Services, Inc.,* [1971] 2 O.R. 141, which deal with subsection 127(1) and section 133 of the Ontario Act.
22. See Scott, *The Law of Trusts* (3rd ed.), Vol. IV, pp. 3054, 3055.
23. *Re Enderton,* [1954] 4 D.L.R. 710 (Man. Q.B.).

24. See *Re Kelley,* [1933] 4 D.L.R. 416, 420 (N.S.S.C.): *Wallis* v. *Solicitor-General for New Zealand,* [1903] A.C. 173 (P.C.).
25. See H.L. Oleck, *Non-Profit Corporations, Organizations and Associations* (2nd ed.), p. 552; Annotation on Charitable Trusts, [1931] 3 D.L.R. 1.
26. See sections 1001 and 1005 of the New York Not-For-Profit Corporation Law, and sections 46 and 47 of The Model Non-Profit Corporations Act.
27. See 35 Harv. Law Rev. 85, (1921-22).
28. See *Re Windsor Medical Services, Inc., (supra).*
29. See, for example, subsection 133(5) of the Ontario Act.