Selected Issues Regarding the Liability of Directors and Officers of Charitable and Nonprofit Corporations[1]

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Introduction

The state of the law in Ontario[2] respecting the liability of directors and officers of charitable and nonprofit corporations[3] is unsettled and unsatisfactory. On the one hand, the Public Guardian and Trustee (PGT) has taken a public position that would, for all intents and purposes, assimilate the role of directors and officers of charitable[4] corporations with that of the trustees of charitable trusts.[5] As will be discussed in some detail, this would subject these directors and officers to a standard of care, and expose them to potential liability, considerably in excess of that applicable to directors of business corporations. On the other hand, tens of thousands of individuals[6] serve as unpaid directors and officers of such corporations and perform a vital social function in so doing; yet, it is unlikely that more than a small fraction of these individuals have any clear idea of the risks that they are undertaking by accepting such positions. While the proposals put forward by the PGT were clearly well-intentioned and would have the merit of creating a far-better-understood code regulating the activities of most charitable corporations, in the authors' view many of the proposals are not in accord with the existing state of the law in Ontario and would, in any event, result in an enormous regulatory burden upon the hard-pressed resources of the vast majority of those Ontario charities that are well-run, honest, efficient organizations playing a vital function in the social matrix of the province. Moreover, such proposals might have the effect of discouraging participation in such organizations by the very people who might be most valuable to them: successful, experienced individuals whose community spirit nevertheless stops short of putting their financial security, and that of their families, at risk.

The Corporate and Insolvency Law Policy Directorate of Industry Canada has introduced a framework paper setting out its proposals for a new *Not-for-Profit Corporations Act*.[7] This Reform Draft Framework, together with the Supplement, if adopted, would greatly clarify these issues. Part IX of the proposed *Not-for-Profit Corporations Act* clearly outlines a director's liability. Some of the issues addressed include a director's duty of care, due diligence defence, liability for wages, and indemnification and insurance. In essence, the duty of

care imposed on directors and officers would be that currently imposed upon directors of business corporations under the Ontario *Business Corporations Act*.[8] In addition, directors would have available a due diligence defence in order to avoid personal liability. However, until this proposal is adopted, the state of the law in Ontario remains unclear.

This article reviews[9] the current state of the law in Ontario respecting the liability of directors and officers of charitable and nonprofit corporations and concludes with a few suggestions on how the law might be clarified and, where necessary, ameliorated, to satisfy the legitimate concerns of the PGT without stifling the creativity and energy of the charitable sector and denying it access to those individuals to whom it can look for guidance and wisdom in the roles of directors and officers.

The Director-Trustee Dilemma

Charitable and nonprofit corporations incorporated under the laws of the Province of Ontario are normally incorporated by letters patent under the provisions of the *Corporations Act*.[10] Part III of that statute governs the incorporation of corporations without share capital.

Although there does not appear to be any statutory warrant for such procedure, since November 1, 1989, the PGT, in conjunction with the Ministry of Consumer and Business Services, has asserted the right to pre-approve all applications for letters patent and supplementary letters patent by charitable and nonprofit corporations under Part III of the *Corporations Act*.[11] Recently, though, the PGT has implemented a "streamlined" approach to such applications. Under this new approach, if pre-approved charitable objects are set forth in the application for incorporation, then the incorporator can apply directly to the Ministry of Consumer and Business Services for incorporation. If the pre-approved objects are not utilized, then the PGT must approve the application, after which the application will be forwarded by the PGT to the Ministry of Consumer and Business Services.[12]

The *Corporations Act* provides a general framework for the regulation of the corporate organization and activities of charitable and nonprofit corporations incorporated under its provisions or (and except as otherwise expressly provided) under the provisions of a general or special *Act* of the Province of Ontario, the late Province of Upper Canada, or the late Province of Canada (having its head office in Ontario, carrying on business in Ontario, and incorporated with objects under the provision of the Legislature of Ontario).[13] Subsection 283(2) provides that such a corporation must have at least three directors, but, unlike the *Business Corporations Act*, there is no requirement that a majority of the directors be resident in Canada. Persons who are under 18 years of age[14] or are undischarged bankrupts are barred from acting as directors.[15] Subsection 286(1) of the *Corporations Act* provides that directors must be members of the corporation.[16] Unlike the *Business Corporations Act*,

which in section 134 sets out an express standard of care applicable to directors of corporations governed by that statute, the *Corporations Act* does not contain any such provision.

The *Charities Accounting Act*, however, provides in subsection 1(2) as follows:

> *Charitable corporations, etc., brought within Act*
>
> 1(2) Any corporation incorporated for a religious, educational, charitable or public purpose shall be deemed to be a trustee within the meaning of this *Act*, its instrument of incorporation shall be deemed to be an instrument in writing within the meaning of this *Act*, and any real or personal property acquired by it shall be deemed to be property within the meaning of this *Act*.

It must first be noted that subsection 1(2) does not constitute a corporation to which it applies as a trustee of its property for any purposes other than the application of the *Charities Accounting Act.* As will be seen, this distinction is significant because there is considerable obscurity in the case law as to the exact position of a charitable corporation with respect to its general assets. Second, the statute does not purport to set out an exclusive code regulating the conduct of such corporations. Generally, it requires that notice of incorporation be given to the PGT.[17] In addition, the statute provides for reporting by such corporations "from time to time upon request" of the PGT.[18] Section 4 of the statute provides specific power for a judge of the Superior Court of Justice, upon application of the PGT, to provide remedies in the case of non-compliance with the provisions of the statute including, in clause 4(h), the issuance of an attachment against a defaulting executor or trustee to the amount of any property or funds for which the executor or trustee is in default. Section 6 confers upon a judge of the Superior Court of Justice, upon complaint made in writing by any person, the power to order the PGT to undertake an investigation into the matter complained of. Sections 8 through 10 deal with the holding of land for a charitable purpose and, in general terms, prohibit such holdings except "for the purpose of actual use or occupation of the land for the charitable purpose."[19] Finally, section 12 of the statute provides:

> *Other rights and remedies not affected*
>
> 12. This *Act* does not apply to or affect or in any way interfere with any right or remedy that any person may have under any other *Act* or in equity or at common law or otherwise.

There are two very significant points to be borne in mind when dealing with the *Charities Accounting Act* in the context of the liability of directors and officers of charitable and nonprofit corporations:

(I) Notwithstanding its name, the statute applies to nonprofit corporations that are not charities, so long as they are incorporated for a religious, educational or public purpose. This would, no doubt, de-

scribe most nonprofit corporations other than social clubs or similar institutions.[20]

(II) The statute imposes liabilities upon the corporation, which it deems to be a trustee for the purposes of the statute. It is silent on the question of directors and officers of such corporations and it does not create any specific statutory jurisdiction to impose liability upon, or otherwise regulate the conduct of, directors and officers. As discussed later, one must look to the common law for such powers.

In addition to the *Charities Accounting Act*, the *Charitable Gifts Act* governs the holding of certain business interests "vested in a person in any capacity for any religious, charitable, educational or public purpose."[21] In very general terms, the statute prohibits such persons from owning more than 10 per cent of any business.[22] As is the case under the *Charities Accounting Act*, the statute applies to non-charitable, nonprofit organizations of a religious, educational or public character. In addition, there is no specific mechanism governing the conduct of, or applying sanctions to, the directors of corporations that contravene the provisions of the statute.

Thus, it can be seen that there is very little substantive legislation governing the conduct of charitable and nonprofit corporations in Ontario.[23] Apart from specific forms of statutory liability, which will be dealt with later, recourse must be had to the common law to ascertain the current state of the liability of directors and officers of such corporations.

In the early 1990s, the PGT of the Province of Ontario stated, in very broad terms, its views of the position of directors of charitable corporations operating within the Province of Ontario.[24] As a matter of policy, it makes, among others, the following recommendations:

> We think that there ought to be a single regime applicable to the administration and management of charitable property (as distinct from organizational and other issues) rather than a multiplicity depending only upon how charities may organize themselves. We think also that the law of charitable trusts ought to apply to the administration and management of charitable property regardless of the form in which a charity may be organized. The considerations that have led the courts to impose the obligations of trustees upon those holding property for charitable purposes are just as compelling if a charity is organized otherwise than as a trust.[25]

Although this passage calls for a uniform application of the law of charitable trusts to all forms of charitable organization, the subsequent discussion appears to be predicated on the assumption that such is already the case. More specifically, the submissions assume the following:

(1) That every charitable corporation is a trustee of all of its assets, not simply those held upon express or implied charitable trusts.

(2) That every director of a charitable corporation is also a trustee of those same assets.

The views expressed would essentially negate the distinctions between charitable trusts and charitable corporations[26] and place a much higher onus on the directors of charitable corporations than on directors of business corporations. As discussed later, this poses significant problems in the areas of remuneration, indemnities, and liability insurance, among others. In addition, it places such corporations in the position of possibly having to make frequent application to court for approval of actions that had previously been thought to be well within the powers of their boards of directors.

In the authors' view, the PGT's previously noted assumptions about the state of the law governing charitable corporations are not an accurate reflection of the applicable authorities. However, in fairness, it must be said that the law in this area is convoluted and difficult. One author has indeed referred to charitable corporations as a "bastardy" legal form.[27] Therefore, one must analyze these two assumptions separately in order to arrive at an accurate reflection of the state of the law.

Charitable corporations are often trustees of express or implied charitable trusts. Thus, for example, when funds are left to a university in trust for the purpose of granting scholarships, that institution is clearly a trustee of those funds and the general law respecting charitable trusts applies to its administration, management, and disbursement of them. When such an institution receives funds for its general purposes, it is not clear that it acts as a trustee of those funds, although it appears to have obligations in respect of such funds that are very similar to those of a trustee:

> The truth is that it cannot be stated dogmatically that a charitable corporation either is or is not a trustee. The question is in each case whether a rule that is applicable to trustees is applicable to charitable corporations, with respect to unrestricted or restricted property. Ordinarily the rules that are applicable to charitable trusts are applicable to charitable corporations, as we have seen, although some are not. It is probably more misleading to say that a charitable corporation is not a trustee than to say that it is, but the statement that it is a trustee must be taken with some qualifications. Thus where property is left by will to a charitable corporation, whether it may be used for the general purposes of the corporation or whether the devise or bequest is subject to restrictions as to its use, and the property is conveyed by the executor to the corporation, the corporation is not thereafter bound to account as if it were a testamentary trustee. The situation is quite different from that which arises where property is left by will to an individual trustee, or to a trust company, charged with a duty to make the property productive and to pay the income to a charitable corporation.[28]

While it might be argued that this amounts to a distinction without a difference, it is of considerable importance in examining the PGT's assertion that all charitable corporations are subject to the general law respecting charitable trusts. No one doubts, for example, that a charitable corporation that applied its funds to noncharitable objects (other than those incidental to its charitable

objects) would be essentially acting in breach of trust. That does not necessarily lead to the conclusion that all of the elements of trust law apply to that corporation. Thus, in the case of matters such as investment policy, indemnification of directors, corporate capacity, etc., it would seem that the relevant law is that under which the corporation was incorporated and organized, not general principles of trust law. It is submitted that if it had been intended to make the administration of such corporations subject to the provisions of the *Trustee Act*,[29] the legislature would have done so in clear terms.

Early case law dealing with both charitable and business corporations tended to refer to directors as "trustees" of corporate assets. In the case of charitable corporations, that misleading terminology has tended to persist. One learned commentator has expressed the reasons for this confusion as follows:

> It is submitted that there is no hidden mystery, no missing link lying undiscovered in the pre-history of company law, behind the trustee appellation: the real mystery is why the old label has survived in modern usage. In the limited legal vocabulary of the day, there was no other word which the judges would wish to use. It was sufficient for them to reason that the directors had accepted an appointment or "trust"; therefore, they were "trustees" and accountable for "breaches of trust". The "trustee" in a strict sense, in whom property is legally vested for the benefit of others, was not separately identified until well into the nineteenth century, when the expression "fiduciary" was eventually accepted to differentiate true trusts from those other relationships, like that between a director or a promoter and his company, which in some degree resemble them.
>
> We should not forget, however, that all fiduciary principles are trust principles, and it is on these trust principles that directors' liability is traditionally determined.[30]

It is true that two Ontario decisions have seemed to proceed upon the basis that directors of charitable corporations are trustees, at least in regard to their ability to receive remuneration or other pecuniary advantage from the corporation.[31] Those two decisions are in turn based on an English case that, it is submitted, may have inadvertently perpetuated the misleading terminology referred to by Sealy.[32] That case concerned a charitable corporation that proposed to amend its bylaws to provide for the remuneration of directors of the corporation who rendered accounts for services provided to the corporation in their professional capacities. Without deciding that the directors were *per se* trustees of the assets of the corporation, Danckwerts J. held that the proposed bylaw, which would benefit some of the directors seeking to enact it, was a breach of the fiduciary obligations of the directors. It is submitted that this decision is not authority for the proposition that directors of charitable corporations are, in all respects, trustees of the assets of those corporations.

We submit that one cannot examine the issue of whether directors of charitable corporations are trustees, in the abstract. One must look to the constating documents of the corporation, including the statute, if any, under which it was

incorporated. It should be noted that *French Protestant Hospital* dealt with a corporation established by Royal Charter in 1718. The directors of charitable corporations are subject to express provisions governing such matters as indemnity and conflict of interest on the same basis as the directors of any non-charitable corporation that is subject to the *Corporations Act*. This legislation is inconsistent with an assertion that the directors of a charitable corporation are per se trustees of the assets of that corporation and should take precedence over any cases dealing with corporations created under other forms of legislation or prerogative instrument.

The case law in this area has been extensively reviewed in recent years by a number of distinguished commentators and, in our view, does not support the position taken by the PGT.[33] The better view seems to be that directors of charitable corporations are not themselves trustees of the general assets of the corporation; they appear to be subject to the same types of fiduciary obligations as are directors of other forms of corporations. Those duties may, however, require greater diligence because of the trustee-like obligations of the corporation with respect to its general assets. It would seem that the lack of clarity in the case law stems from early cases that confused the concepts of trusteeship and directorship at a time when the law relating to the rights and obligations of directors was itself undeveloped. It may have also stemmed, in part, from a tendency of boards of directors of charitable corporations to style themselves a "Board of Trustees." Nevertheless, there is little support in the jurisprudence for the suggestion that the directors of a charitable corporation are, as such, trustees of the assets of the corporation. In addition, the *Unity Church* case[34] casts some doubt upon the validity of earlier case law in this area which characterizes directors of charitable corporations as trustees. As a result, any analysis of the liability of directors of charitable corporations must proceed on the basis of analyzing the general law applicable to directors under the provisions of the legislation by which such corporations are created and governed.

Statutory Liability

A wide variety of federal and provincial statutes creates specific offences, penalties and remedies covering acts or defaults of directors or officers of corporations. Many of these provisions fall in the area of offences of a criminal or quasi-criminal nature. Generally speaking, such statutes recognize that a corporation, apart from the imposition of a pecuniary penalty, cannot be made to feel the full weight of the criminal law or quasi-criminal sanctions, unless the directors and officers of the corporation can themselves be exposed to such sanctions for guiding or acquiescing in the impugned conduct of the corporation. Thus, for example, section 242 of the *Income Tax Act* (*ITA*) provides as follows:

> *Officers, etc. of corporations*
>
> 242. Where a corporation commits an offence under this *Act*, any officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in,

> or participated in the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.

The *ITA* creates two principal types of offence: (a) offences under section 233 (commonly known as tax evasion), which require proof of *mens rea* on the part of the accused; and (b) offences under section 238 (such as failure to keep proper books and records), which are offences of strict, although not absolute, liability. Offences of strict liability admit of a defence of due diligence. It seems, however, that where a director or officer of a corporation is prosecuted under section 242 (or an analogous provision) in respect of the commission of a strict liability offence by a corporation, it is nevertheless necessary to prove *mens rea* on the part of such director or officer.[35]

In addition to criminal or quasi-criminal provisions, many statutes provide penalties if directors fail to live up to their obligations as directors. A smaller number of statutory provisions provide a civil remedy against directors for such purposes as ensuring the payment of taxes, withholding tax obligations, obligations to employees, or liability for environmental damage. This section examines an illustrative, but not exhaustive, list of such provisions.

1. *The Corporations Act*

The *Corporations Act* creates a number of specific regulatory offences dealing with directors and officers who fail to live up to their obligations under that statute. Section 303 makes it an offence for a director, officer or employee to make or assist in making any false entry in the minutes of the corporation or in other documents, registers, and books of account required to be kept by the corporation under the provisions of the *Act*. Subsection 304(4) makes it an offence for any director, officer or employee of a corporation to contravene subsection 304(1), which provides for inspection of corporate records by authorized persons (generally, directors) during normal business hours. Similar provisions are found in subsections 305(1) and (2) dealing with records being available to members. Use of a list of members, other than by a corporation or its agent, to sell securities, or for purposes not connected to the corporation, is an offence under subsection 306(2); in addition, selling such a list is an offence under section 308.[36] Subsection 330(1) makes it an offence to make or assist in making a statement in any return, certificate, financial statement or other document required by or for the purposes of the *Act* or the regulations under the *Act*, knowing it to be untrue. Finally, section 331 of the *Act* provides:

> *General penalty*
>
> 331. Every corporation that, and every person who, being a director or officer of the corporation, or acting on its behalf, commits any act contrary to this *Act*, or fails or neglects to comply with any such provision, is guilty of an offence and on conviction, if no penalty for such act, failure or neglect is expressly provided by this *Act*, is liable to a fine of not more than $200.

While the *Corporations Act* contains a substantial arsenal of provisions aimed at defaulting directors, it must be said that prosecutions under these provisions appear to be extremely rare.

Of more direct interest to many persons serving as directors of charitable and nonprofit corporations is subsection 81(1) of the *Act*, which provides:[37]

> *Liability of directors for wages*
>
> 81(1) The directors of a company are jointly and severally liable to the employees, apprentices and other wage earners thereof for all debts due while they are directors for services performed for the company, not exceeding six months wages, and for the vacation pay accrued for not more than twelve months under the *Employment Standards Act* or any predecessor thereof and the regulations thereunder or any collective agreement made by the company.

This provision, together with withholding tax requirements under the *ITA* and similar federal statutes, represents probably the most immediate risk to the directors of such corporations. Under subsection 81(2), however, a director is not liable for such claims unless, *inter alia*, the company has been sued within six months after the debt became due and the director has been sued within six months after he or she ceased to be a director.[38] Notwithstanding this limitation, the provision seems to be one of absolute liability. In other words, no due diligence or other defence is available upon the debt(s) being proven. As a consequence, it is critical for directors of such corporations to ensure that obligations to employees are kept current.

2. *The Income Tax Act*

Both registered charities and nonprofit corporations are exempt from tax under Part I of the *ITA*.[39] This, however, is not an exemption from the reporting and compliance requirements of Part I or from the general rules contained in Parts XV through XVII of the *ITA*. Registered charities are subject to a relatively stringent code of regulation set out primarily in section 149.1 of the *Act*.[40] Failure to abide by these provisions can lead to revocation of a charity's status and the forced liquidation of its assets in light of the possible application of section 188. In addition, the criminal sanctions set out in sections 238 and 239, discussed previously, could be applied to the directors and officers of such a corporation in an appropriate case. Nonprofit organizations are not subject to as strict a regulatory code under the *Act*, but they must file annual income tax returns[41] and, along with their directors and officers, are subject to the provisions of sections 238 and 239.

Finally, and perhaps most worrisome to the directors and officers of such corporations, are the provisions of section 227.1 of the *ITA*, which impose direct personal liability, in certain cases, on directors of a corporation that has failed to deduct (or withhold) and remit amounts as required by the *Act* or the regulations. In general terms, the directors of charitable and nonprofit corpo-

rations would be concerned principally with source deductions in respect of various forms of remuneration[42] and, possibly, withholding taxes in respect of payments to non-resident persons.[43]

By way of summary, it is very difficult to express with any degree of certainty what amounts to due diligence for the purposes of section 227.1(3) of the *ITA*. The reported cases on section 227.1 since it was introduced[44] are myriad and difficult to reconcile. For the purposes of this article, it is sufficient to state that the courts have imposed a relatively stringent standard of diligence upon directors assessed under this provision. However, there is some indication in the case law of an element of subjectivity in the test imposed, in that the standard may not be as onerous for unsophisticated directors with a lower level of qualifications and skills. On the other hand, what is clear is that the standard is the same whether a director is acting for either a for-profit or nonprofit corporation. As noted previously, one of the problems in this area is that it is often difficult to ascertain precisely when a director resigned from office; individual directors are often under the misapprehension that they have resigned from office when, in law, they have not.[45]

3. *Environmental Protection Legislation*

While directors of charitable and nonprofit corporations will properly face environmental problems far less frequently than directors of business corporations, these environmental liabilities cannot be overlooked. Many charitable and nonprofit corporations own large tracts of land in connection with their activities.[46] In such cases it is extremely important to establish and maintain a strict program of environmental monitoring of the use of land owned or occupied by the corporation.

Typically, statutes dealing with the environment provide that directors can be subject to penal sanctions for any acquiescence or participation in the offences under the statute. Directors of Canadian companies have faced personal liability, but there are few such cases so far.[47] In the current political climate, however, greater scope for prosecution exists.

Under the *Canadian Environmental Protection Act, 1999*,[48] directors and officers will have to be more vigilant in respect of environmental issues. The changes expand the potential liability of directors and officers for environmental harm and require an increased focus on due diligence. The old provision imposed liability on a director or officer for "knowledge" of the commission of an offence by the corporation under the *Act*. Under the current provision,[49] directors and officers are under a general positive duty to "take all reasonable care to ensure" that the corporation complies with the *Act* and the regulations. Moreover, directors can be prosecuted for offences under the *Act* notwithstanding that the corporation itself is not being prosecuted.[50] This statute and its regulations impose a variety of obligations ranging from the provision of information to the federal Minister of the Environment to proper storage and

disposal of toxic substances. Fines for many offences can be up to $1 million; for other offences there is no maximum limit. Imprisonment for up to five years is provided for in the statute, but if any conduct in relation to the environment causes death or bodily harm and the directors acted in wanton or reckless disregard for those lives, then prosecution may take place under the *Criminal Code*,[51] exposing the director to a penalty of life in prison.

The Ontario *Environmental Protection Act*,[52] to some extent, duplicates provisions of the federal statute, and the interaction and degree of overlap between the two create some uncertainty. The Ontario legislation specifically requires that directors take reasonable care to prevent the unlawful discharge of a contaminant into the natural environment and failure to do so is an offence under the *Act*.[53] It must be borne in mind that "contaminant" is defined in an extremely broad manner. Similar duties exist under the Ontario *Pesticides Act*[54] and the *Ontario Water Resources Act*.[55]

Also, under the provincial legislation any person (conceivably a director) who has control of a pollutant is, *inter alia*, responsible for cleaning up, or for reimbursing others (including the government) for loss or damage incurred as a direct result of the spill of the pollutant.[56] The regulators can obtain orders against persons responsible for a source of a pollutant requiring various cleanup measures and, if the orders are not complied with, the government can undertake the cleanup and seek reimbursement from those who should have complied with the order.[57] In appropriate cases, a director could be liable for such costs.

4. *The Excise Tax Act*[58]

With the introduction of the Goods and Services Tax (GST) under Part IX of the *Excise Tax Act*, charitable and nonprofit corporations have become subject to yet another comprehensive and complex scheme of statutory regulation. It is beyond the scope of this article to attempt to describe the application of GST to such corporations. In simple terms, they are required to pay GST on most acquisitions of goods and services, other than exempt supplies, and certain charities and a limited number of nonprofit corporations are entitled to a rebate of GST paid by them equal to the prescribed percentage set out in the *Public Service Body Rebate (GST) Regulations*.[59] This may vary between 50 per cent[60] and 83 per cent.[61] In addition, charitable and nonprofit corporations are required to collect and remit GST on most goods and services provided by them to the public in the course of a commercial activity.

Section 323 of the *Excise Tax Act* is essentially a counterpart to section 227.1 of the *ITA*, discussed previously. It imposes direct liability on the directors of corporations who fail to remit "net tax" as required by subsection 228(2) or (2.3) of the *Excise Tax Act*. The limitation on such claims expires two years after the person ceased to be a director of the corporation, and the defence of due diligence is available to directors in much the same fashion as under the *ITA*. The *Excise Tax Act* also contains both regulatory[62] and *mens rea*[63] offence

provisions for which an officer, director or agent may be convicted, whether or not the corporation has been prosecuted or convicted.[64] In addition, GST collected under the *Excise Tax Act* is the subject of a statutory trust:

> *Trust for amounts collected*
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> 222. (1) Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from the property held by any secured creditor of that person that, but for the security interest, would be the property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
>
> *Amounts collected before bankruptcy*
>
> (1.1) Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act*), to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.
>
> *Withdrawal from trust*
>
> (2) A person who holds tax or amounts in trust by reason of subsection (1) may withdraw from the aggregate of the moneys so held in trust
>
> (a) the amount of any input tax credit claimed by the person in a return under this Division filed by the person in respect of a reporting period of the person, and
>
> (b) any amount that may be deducted by the person in determining the net tax of the person for a reporting period of the person,
>
> as and when the return under this Division for the reporting period in which the input tax credit is claimed or the deduction is made is filed with the Minister.
>
> *Extension of trust*
>
> (3) Despite any other provision of this *Act* (except subsection (4)), any other enactment of Canada (except the Bankruptcy and Insolvency *Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
>
> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
>
> (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and

> apart from the estate or property of the person and whether or not the property is subject to a security interest
>
> and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.[65]

It is possible that the creation of this statutory trust may impose trust obligations upon directors and officers of corporations in addition to the liability created under section 323 of the *Excise Tax Act*. The matter is far from clear, but this possibility would suggest that it might be prudent for directors to establish a separate trust fund for GST remittances.

5. *Other Statutes*

Part XX of the Ontario *Employment Standards Act, 2000*[66] deals with the liability of directors and imposes personal liability on them in various circumstances. The provisions, however, do not apply to the following types of directors: (a) directors of corporations to which Part III of the *Corporations Act* applies or to which the *Co-operative Corporations Act* applies;[67] or (b) directors of corporations incorporated in another jurisdiction, that have objects similar to those of Part III corporations or co-operative corporations and that are carried on without the purpose of gain.[68] Where Part XX of the *Act* applies, directors of corporations with employees in Ontario are personally responsible for up to six months' wages, including overtime pay, vacation pay, and holiday pay, as well as interest on such amounts, but not including severance or termination pay.[69] In addition, liability for vacation pay extends to twelve months. While this Part does not apply to directors of nonshare capital corporations, where an order is made against a corporation to pay any of these amounts and it is not complied with, it is an offence under the *Act* and exposes directors to a fine of up to $50,000.[70] In addition, directors and officers of a corporation who authorize, permit or acquiesce in a contravention of the *Act* by the corporation (which includes the non-payment of wages owing) are also liable for the offence and the penalty flowing from it.[71] Liability may be imposed whether or not the corporation has been prosecuted or convicted of the offence.[72] In effect, while it may appear at first blush that directors of non-share capital corporations are shielded from liability in this regard, it is the authors' view that in reality there remains a significant risk of liability.

Under the Ontario *Pensions Benefits Act*,[73] a corporate employer that is required to make contributions to an employee pension plan is required to hold such monies in trust for the employees who are employed in Ontario. Although this is primarily a corporate obligation, directors or officers who cause, authorize, acquiesce or participate in any contravention of the *Act*, including failure to make payment to a pension fund, are also guilty of an offence[74] and may be ordered by the court to make the contributions.[75] Failure to comply with this

Act can expose the director to a fine of up to $100,000 on first conviction and up to $200,000 on subsequent convictions.[76]

The Ontario *Employer Health Tax Act*[77] also imposes a tax on corporate employers to support the health insurance scheme. It is an offence to evade payment of the tax and directors could be subject to a penalty if they direct, authorize, assent to, acquiesce in, or participate in the commission of such an offence by the corporation.[78]

Ontario's *Occupational Health and Safety Act*[79] imposes an obligation on directors to take all reasonable care to ensure that the corporation complies with the *Act*, regulations and any orders made thereunder.[80] Under the *Act* and regulations, the corporation must ensure, *inter alia*, the safety of a plant, including providing prescribed and functioning safety equipment to workers, appointing competent supervisors, carrying out the safety procedures in the regulations, and providing information, instruction and supervision to workers to protect their health and safety. Failure to perform any one or more of these statutory duties could expose a director to a fine of up to $25,000 and up to one year in prison.[81]

Rights and Responsibilities

1. *Directors*[82]

The *Corporations Act*, unlike the *Business Corporations Act*,[83] does not contain any express statutory test for the duty of care imposed on directors.[84] Thus, recourse must be had to the common law.

As has been discussed, the primary source of debate in the case of the general standard of care applicable to directors of charitable and nonprofit corporations is whether, in the case of charitable corporations, the directors are trustees of the general assets of the corporation. Trustees, as noted previously, are under significantly more stringent fiduciary obligations than those imposed on directors of business corporations under the express provisions of the Ontario *Business Corporations Act* (OBCA) or under the common law standard of directors' liability. Directors of charitable corporations are not, in law, trustees of the general assets of the corporation, so the following analysis will attempt to describe the standard of care applicable to the directors of both charitable and nonprofit corporations on the assumption that directors of charitable corporations are not under trustee obligations (other than in the case of assets that are the subject of an express or implied trust).

The "Business Judgment Rule"

The common law test setting out the standard of care applicable to directors derives from the early judgment of the English Court of Appeal in *In Re City Equitable Fire Insurance Co., Ltd.*,[85] where it was held that:

(1) directors need not exhibit a greater degree of skill than may reasonably be expected from persons with their knowledge and experience;

(2) directors are not liable for errors in business judgment, as their primary function is to use their own particular talents in advocating corporate risk taking; and

(3) directors are not bound to give continuous attention to the affairs of the corporation and "in the absence of grounds for suspicion" they can trust corporate officials to be honest.

In other words, under the common law test there is no high objective standard generally expected of directors, and their business judgment will not be questioned by the courts.

The common law standard requires directors to act with the degree of reasonable prudence that might be expected of persons with their knowledge and experience. Thus, the standard is subjective and arguably imposes greater responsibilities on directors who are knowledgeable in business, financial or legal matters. While this may provide some measure of comfort to volunteer directors who are not particularly sophisticated in such matters, it may act as a deterrent to individuals who are. Moreover, it has the disadvantage of imposing an unequal standard on the members of the same board and creating considerable difficulties in determining what would amount to reasonable prudence on the part of individuals with varying degrees of sophistication, experience, and training.[86]

Early common law cases considering the degree of attention directors were to give to their task imposed almost no objective standard of diligence. In our view, it would be unwise to assume that such early case law continues to govern the standard of care applicable to directors of charitable and nonprofit corporations. This is because the statutory test found under the Canada *Business Corporations Act* (CBCA) imposes some objective standard of diligence. In addition, subsection 135(4) of that statute expressly encourages reliance on the advice of various professionals for those situations in which the director does not have the requisite skill; consequently, the duty to be diligent with respect to a business corporation could require that the director seek out professional assistance in certain circumstances. Attendance at most board meetings would also seem to be required. Although the traditional common law test imposed a fairly lax standard in this regard, it seems likely that the courts would raise the expected common law standard applicable to charitable corporations to bring it more in line with the statutory modifications applicable to business corporations.

The business judgment rule essentially amounts to a limited right to be wrong. That is, directors are permitted to err in situations requiring business judgment so long as they act in good faith and meet their other obligations to the corporation during the course of the decision-making process. The rule evolved, however, in the context of business corporations and the reluctance of the courts to become arbiters of business decision-making. It is unclear what application, if any, the rule has to the judgments associated with charitable or philanthropic activity. On the one hand, such activities can be seen as closely

analogous to certain forms of business operation.[87] On the other hand, it could be argued that decisions respecting the use to be made of charitable funds should require a greater degree of attention and prudence than might be realistic in the heated atmosphere of the marketplace. On balance, it would seem that the business judgment rule probably has some application in this area, but undue reliance upon the efficacy of this rule is probably not merited, particularly in the case of charitable corporations.

Duty of Obedience

The common law duty of obedience has two aspects. First, a director is obliged to assist in implementing valid corporate decisions; failure to do so might amount to a breach of duty to the corporation. Second, a director is obliged to see that the corporation and its officers and agents obey the general law applicable to the corporation.

Duty of Good Faith

The requirement that directors act in good faith embraces two concepts: (a) directors should not profit from their dealings with the corporation (discussed in more detail under the topic of conflicts); and (b) directors should make decisions with the best interests of the corporation in mind, not to further personal non-pecuniary interests. In the case of charitable corporations, this may become a problem when, for example, a director wishes to use the funds or property of the corporation to further the activities of other institutions in which he or she has a charitable or philanthropic interest. Therefore, it can be argued that for a director to support, for reasons of a personal but non-pecuniary nature, the use of one charitable corporation's assets in the activities of a second charitable corporation that is unrelated to the charitable objects of the former, constitutes a breach of that director's obligation of good faith to the corporation.

Conflict of Interest

Early judicial decisions considering directors' fiduciary duties to the corporation, including their duty to avoid conflicts of interest, precluded directors from entering into arrangements with the corporation by which they sought to obtain personal benefits. Subsequent case law ameliorated the harsh effect of this judicial rule by exempting transactions where shareholder ratification of the arrangement was obtained.

The *Corporations Act* has adopted "safe harbour" provisions which extend the ability of directors to enter into such arrangements.[88] Generally, if the nature of the director's interest is fully disclosed to the directors[89] and if the director does not vote on the resolution approving the transaction, the director will not be liable to account for any profit or gain and the transaction will not be voidable by reason of the relationship.[90] It is unclear, however, whether the director can be included in the determination of the quorum for the purposes of dealing with the proposed transaction. In addition, it is unclear whether the

director can be present in the room while the matter is being discussed. The prudent course would probably be for the director to leave the meeting until the transaction has been discussed and a vote taken. Furthermore, if there is subsequent approval of a transaction by a majority of members at a members' meeting duly called to consider the transaction, and if the notice of that meeting discloses the director's interest, he or she will be shielded from the liability to account notwithstanding an initial lack of disclosure.[91]

If the director fails to comply with the provisions in the *Corporations Act*, the members and the corporation itself may apply to the court to have the transaction set aside and to have an accounting of the director's profits. In addition, failure to comply with the *Act* in such circumstances is an offence punishable by a fine of not more than $200.[92]

As has been noted, the PGT takes the position that directors of charitable corporations are trustees and cannot benefit from the trust without the express sanction of the court given under the provisions of the *Trustee Act*. If that interpretation is correct (in our view it is not), then section 71 of the *Corporations Act* may not protect a director, notwithstanding compliance with its provisions. Unless and until the matter is clarified by the courts or the legislature, directors with material pecuniary interests in a contract that is about to be entered into by a charitable corporation should probably disclose their interest immediately upon becoming aware of it and resign from the office immediately thereafter (or seek a court order to sanction the transaction).

Corporate Opportunity

It is a generally recognized principle of Canadian corporate law that, as part of their fiduciary obligations, directors must not take personal advantage of opportunities that come their way by virtue of directorship, particularly where those opportunities might be exploited by the corporation. The leading Canadian case on what has become known as the "corporate opportunity doctrine" is the 1973 decision of the Supreme Court of Canada in *Canadian Aero Service Ltd. v. O'Malley*.[93] The Court held that directors or senior officers are precluded from obtaining for themselves, either secretly or without the approval of the corporation (after full disclosure), any property or business advantage either belonging to the corporation or for which it has been negotiating, especially where the director or officer is a participant in the negotiations. It was further held that there was no precise test to determine when directors or senior officers would be entitled to make use of an opportunity that arose by virtue of their positions with the corporation. However, in the following passage from the judgment, a number of factors were enumerated by the Court to assist in determining this question:[94]

> The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt

> to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness [*sic*] and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special, or indeed, even private...

In the *Canadian Aero Service* case, the senior officers were held liable notwithstanding that they had left the corporation at the time that they bid on the project upon which the corporation was also bidding. In a more recent British Columbia case, *Roper v. Murdoch*,[95] the former officers were held liable for usurping a maturing business opportunity which the corporation had been actively pursuing, notwithstanding that the corporation was about to go bankrupt. Cohen J., relying on *Canadian Aero Service*, held that the fact that the company might not have been able to benefit from the transaction was immaterial because directors must not be allowed to use their position to make a profit even if it was not open to the company to participate in the transaction. What this case illustrates, in other words, is that the standard is a relatively high one, not necessarily dependent on whether the corporation would have actually been able to profit from the opportunity. This rule regarding opportunities that may come a director's way by reason of being in that position applies to potential, as well as actual, conflicts of interest.

If the information or opportunity comes to directors other than by reason of their position as such, they may still be liable to account to the corporation. In such cases there is an actual, as opposed to a *potential*, conflict of interest and duty. For example, directors on the negotiating team for a lucrative contract for the corporation would be in breach of their fiduciary duty to the corporation even if they had been approached by the other party to bid on the contract personally because of an excellent reputation in the industry. Although such conflicts are undoubtedly less likely in the charitable and nonprofit sector, one can imagine circumstances under which they might arise. If, for example, a charitable corporation were approached to sponsor a potentially lucrative entertainment venture, a director would be precluded from using that information to sponsor the event for personal profit.

In the case of both nonprofit organizations[96] and registered charities,[97] the *ITA* requires that no part of the income[98] of the corporation may be payable to, or otherwise available for the benefit of, any proprietor, member, shareholder, trustee, or settlor of the corporation. Since directors will almost invariably be members of the corporation,[99] this prohibition would normally extend to the directors of all such corporations. The Canada Revenue Agency (CRA) has taken the position that this prohibition does not extend to the payment of reasonable salaries and other benefits for services rendered to an organization or to reimbursement for expenses properly incurred on behalf of the organization.[100]

In the case of registered charities, the present state of the case law in Ontario suggests that directors are not entitled to hold salaried positions[101] without the approval of the court.[102] This is the current position taken by the PGT[103] and is, as discussed previously, predicated on the concept that every director of a charitable corporation is, as a matter of law,[104] a trustee of the property of the corporation and therefore prohibited from making a profit from that office without the sanction of a court under the authority of the *Trustee Act*. While there is obviously considerable merit in the proposition that directors of charitable corporations should not be in a position to enrich themselves at the expense of the corporation, the *ITA* already provides an effective monitoring of, and sanction for, such conduct since it could lead to the deregistration of the charity if amounts paid were "unreasonable." It would seem to make little sense to flood the courts with applications to permit the payment of normal salaries to full-time employees of a charity who happen to be board members as well. Nor does it seem to make any sense to prohibit such individuals from serving on boards of directors since often they will be among the most knowledgeable and experienced members of the board. In our view, this matter is in critical need of legislative reform.

The PGT does not object to reimbursement of reasonable out-of-pocket expenses incurred by directors of charities in carrying out their duties.[105] The prohibition against self-dealing by trustees has never extended to reimbursement for actual expenses incurred.

Finally, the ambit of this particular rule is unclear. It probably extends to payments to organizations such as partnerships in which a board member has a direct pecuniary interest; e.g., a charity should probably not conduct business with an architectural partnership if one of the partners is a director of the charity. Where the pecuniary interest is less direct, such as would be the case where payments are made to a corporation of which a director is a shareholder, the situation is unclear. At present, prudence would suggest that such contracts be avoided unless one is dealing with, for example, a minor holding of a public corporation. In such a case, however, one would still have to comply with the conflict of interest rules discussed previously.

2. Officers

In most jurisdictions, the governing corporate legislation is silent concerning the topic of officers, other than to specify that the bylaws should set out the manner of appointment or election of officers and the manner of their removal.[106] In Ontario, however, the *Corporations Act* provides that both the president and the chair of the board of directors must be directors and members of the corporation.[107] The *Act* also provides that the directors must elect the president from among themselves.[108] The directors must also appoint a secretary and may appoint one or more vice-presidents and other officers.[109] In the case of non-share capital corporations, the officers of the corporation may be elected or appointed at a general meeting of the members, if the letters patent,

supplementary letters patent, or bylaws so provide.[110] It must be remembered, however, that the Ontario *Corporations Act* requires that the president be a director regardless of the manner of election. In this regard, the decision as to which body will elect the officers of the corporation is an important one, as it will generally determine who defines the rights and obligations that attach to the offices and who has the power to remove officers and fill vacancies.[111]

Generally, most corporations without share capital will have, at a minimum, a president, a secretary, a treasurer (or a secretary-treasurer), and an executive director.[112] However, corporations have a considerable amount of freedom to specify the offices in their bylaws. Regardless of the composition of the board and the manner of electing the officers, these positions inevitably carry with them a certain amount of prestige and a corresponding amount of responsibility.

Fiduciary Obligations

As mentioned earlier, the Supreme Court of Canada decision in *Canadian Aero Service Ltd. v. O'Malley* established that directors or senior officers are precluded from obtaining any property or business advantage for themselves either belonging to the corporation or for which it has been negotiating, especially where the director or officer is a participant in the negotiations. In the course of his reasons, Laskin J. discussed the duties owed to the corporation by senior officers, whether or not they had been properly appointed as directors. He concluded that senior officers owe a more exacting duty than mere employees, which, unless modified by statute or contract, is similar to that owed to a corporate employer by its directors. It is a fiduciary duty, which includes loyalty, good faith and avoidance of a conflict of duty and self-interest. Although *Canadian Aero Service* dealt specifically with officers of a business corporation, the principles enunciated by Laskin J. may be extended to officers of a non-share capital corporation. It must be remembered that a fiduciary duty arises not so much from the formal relationship of the parties – although this is often important in determining whether fiduciary duties are owed – but from the nature of the relationship. If one party undertakes to act primarily for another's benefit, then a fiduciary duty will arise. Since non-share (nonprofit and charitable) corporations are by their very nature intended to benefit some social welfare purpose, officers of such corporations are, undoubtedly, obligated to serve the corporation loyally and in good faith, and to avoid a conflict of duty and self-interest.

Duty of Care

As in the case of directors, there is no statutory test for the duty of care imposed on officers of a corporation under the *Corporations Act*. Under subsection 122(1) of the C*BCA* and subsection 134(1) of the O*BCA*, however, both directors and officers of a corporation must, in exercising their powers and discharging their duties, act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. As

noted previously, it is not clear whether this objective standard applies to directors of non-share capital corporations; it is even less clear whether it applies to officers. Whereas recourse to the common law has, in the past, been particularly helpful in respect to the standard of care applicable to directors, it has not been particularly helpful concerning the standard applicable to officers. The common law test, as set out in *In Re City Equitable Fire Insurance Co., Ltd.*, appears to apply exclusively to directors. Moreover, as has already been suggested, it is likely that the courts will upgrade the common law standard applicable to charitable corporations to bring it more in line with the statutory modifications applicable to business corporations. In our view, it is likely that officers will be held to the same objective standard.

Statutory Liability

While liability most often attaches to directors, it should be noted that it could also attach to officers in the corporation. Under the Ontario *Environmental Protection Act*, for example, every director or officer of a corporation has a duty to take reasonable care to prevent the corporation from discharging a contaminant into the natural environment.[113] Every director or officer who fails to carry out that duty is guilty of an offence[114] and is liable to conviction, whether or not the corporation has been prosecuted or convicted.[115] Similarly, under the *ITA*,[116] where a corporation is guilty of an offence under the *Act*, an officer, director or agent of the corporation who directed, authorized, assented to, acquiesced to, or participated in the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted. Officers are also exposed to liability under the *Excise Tax Act* and the *Corporations Act*.

Investments

There appears to be no general restriction upon the investment of funds by a non-charitable, nonprofit corporation.[117] In the case of a charitable corporation, the basic question is whether it is free to invest its funds or whether it is circumscribed by the rules respecting trustee investments authorized by the *Trustee Act*.[118] The "classes of investments" authorized before the *Trustee Act* was revised were narrow and very conservative, and there might have been very sound reasons for investing in other forms of security, or in different proportions from the ones set out in those rules. With the amendment to the *Trustee Act*,[119] however, any property is an authorized investment if it is a "form of property in which a prudent investor might invest."[120] Moreover, trustees are held to a standard of care in respect of investments made with the trust property that requires that they "exercise the care, skill, diligence and judgment that a prudent investor would in making investments."[121] Trustees will not be held liable "for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable

assessments of risk and return, that a prudent investor could adopt under comparable circumstances."[122] Nonetheless, one must bear in mind that these provisions do not "authorize or require a trustee to invest in a manner that is inconsistent with the terms of the trust."[123] As such, trustees may rely on the "prudent investor rule" only to the extent that their conduct is not inconsistent with express provisions, if any, in the trust document.

Borrowing

Section 59 of the *Corporations Act* permits a corporation subject to its provisions to pass borrowing bylaws; however, they must be passed by a two-thirds majority of the votes cast at a general meeting called for considering them. Subsection 133(1) of the *Act* makes this provision applicable to charitable and nonprofit corporations governed by Part III of the statute. Such bylaws are regularly passed in the routine organization of corporations. Noncharitable, nonprofit corporations would seem to be able to borrow in much the same fashion as business corporations. The same seems to be generally true of charitable corporations, with two important exceptions. First, the *ITA* prohibits charitable foundations (whether public[124] or private[125]) from incurring debt after June 1, 1950, "… [o]ther than debts for current operating expenses, debts incurred in connection with the purchase and sale of investments and debts incurred in the course of administering charitable activities." This provision is relatively generous and it is not entirely clear what type of debt would be prohibited. Presumably capital borrowings and borrowings to finance past deficits are what the provision is aimed at. In any event, directors of a charitable foundation should be very careful about authorizing borrowing and should consult with counsel, or possibly the CRA, to ensure that any proposed borrowing does not come under this prohibition.[126] Second, directors should be careful to determine that any security given for a loan is the property of the corporation and not trust property. It would be a breach of trust for a corporation to pledge property that was the subject of an express or implied charitable trust as security for borrowing for its general purposes.[127]

Business Activities

Nonprofit corporations are not constrained as to the carrying on of business activities, except to the extent that the activities become so prominent that the corporation can no longer be said to be operated exclusively for purposes other than profit. In other words, if the business becomes an end in itself, rather than a means to an end, the corporation runs the risk of losing its tax exemption. Registered charities, on the other hand, are under more detailed restrictions under the *ITA* as to the nature of business activity that they can undertake. Private foundations cannot undertake any business activity whatsoever.[128] Charitable organizations[129] and public foundations[130] are permitted to carry on a "related business." The term "related business" is defined in paragraph 149.1 of the *ITA*:

> "related business" in relation to a charity, includes a business that is unrelated to the objects of the charity if substantially all[131] persons employed by the charity in the carrying on of that business are not remunerated for that employment;

The definition is inclusive and by necessary implication it would seem that a business related to the "objects of the charity" would qualify as a related business.

The only Canadian authority on the meaning of "related business" is the decision of the Federal Court of Appeal in the case of *Alberta Institute on Mental Retardation v. Canada*.[132] The Institute had been formed to raise funds for various registered charities involved with assisting the mentally handicapped. It raised funds by soliciting donations of household items from the public and then selling those items to a commercial enterprise under a contractual arrangement. The Federal Court of Appeal held that, although this was a business activity, it was a "related business" because all of the funds raised were used for its charitable purposes and it had no profit motive. The Court placed this activity in the same category as the operation of a cafeteria by an art gallery or the operation of a parking lot by a hospital. This was not a "substantial commercial business."

In our view, this decision should not be taken as authority for the proposition that a related business is any business in which all of the profits are used for charitable purposes.[133] Rather, the Court seems to have been saying that the activity in question was subordinate and incidental to the charitable activities of the Institute, particularly in view of the fact that the merchandise sold was donated by the public and of a kind that the charity could not use directly in its charitable activities. No decision has yet examined the question of what amounts to a "substantial commercial business," but it would appear to be a business activity (other than one incidental to the operations of the charity) that could not be said to be "related" to the "objects of the charity."

In this context, the term "objects of the charity" seems to be used in a technical sense, i.e., the category of charitable activity within the rules set out in *Pemsel* under which the entity acquires its "charitable" status.[134] Thus, with the exception of business activities that are carried on almost exclusively by unpaid volunteers, a charity can only carry on business activities (other than incidental business activities) that inherently advance its stated purposes, e.g., relief of poverty, advancement of education, etc. The carrying on of a business in violation of these rules could lead to the revocation of the registration of the charity and would arguably be an actionable breach of duty by the directors and officers of the corporation.

Given the lack of clarity regarding this issue, the CRA intends to issue an administrative policy on what constitutes a "related business" in order to clarify how it will interpret the law both for its own guidance and that of the charitable sector.[135] To this end it requested comments and suggestions on how to

improve the proposed guidelines. Under the guidelines, the term "business" in the charity context would mean commercial activities or, more precisely, the seeking of revenue by providing goods and services to people in exchange for a fee. As a result, the general definition of "business" in the *ITA* would be regarded as inapplicable in the charity context. Regarding what constitutes a related business, apart from businesses run by volunteers, the CRA proposes to clarify the definition as follows: "related businesses" are those that are: (A) linked to a charity's purpose, and (B) subordinate to that purpose."[136] A business will be considered to be linked to a charity's purpose if it is a usual and necessary concomitant of core programs, an offshoot of a core program, and a use of excess capacity. A business will be considered to be subordinate to a charity's purpose if it remains subservient to a dominant charitable purpose, as opposed to becoming a non-charitable purpose in its own right. This requires looking at the business activities in the context of the charity's operations as a whole.

As has been noted previously, the *Charitable Gifts Act* requires that where "an interest in a business that is carried on for a gain or profit is given to or vested in a person in any capacity for any religious, charitable, educational or public purpose,"[137] that person shall dispose of that portion of the interest that represents more than 10 per cent of such business. Generally speaking, the statute provides that such disposition must be made within seven years of acquiring the business.[138] It is difficult to ascertain how this requirement would interact with the concept of "related business" discussed previously. In our view, however, the concept of "related business" under the *ITA* is narrower than the concept of a "business carried on for gain or profit" set out in the *Charitable Gifts Act*. A "related business" is not carried on for gain or profit, as such, but to advance in a direct fashion the charitable objects of an organization. If this conclusion is correct, then presumably such businesses would not be subject to the mandatory divestiture provided for under the *Charitable Gifts Act*. In the case of a nonprofit organization, as noted previously, such activities cannot be carried on for the purpose of profit; once profit becomes an operating motivation, it ceases to qualify for the tax exemption set out in paragraph 149(1)(l) of the *ITA*. Based on this analysis, business activity that would not disqualify the organization under the *ITA* should not be subject to the provisions of the *Charitable Gifts Act.*

Political Activities

There are no special restrictions upon political activity by nonprofit corporations that are not charities.[139] Charities, however, are under very severe restrictions as to the amount and nature of political activities that they are permitted to engage in. First, at common law, political activity is not regarded as charitable[140] on the basis of the judicial fiction that the law is presumed to be correct and lobbying for changes in the law cannot therefore be in the public interest. The *ITA* was amended, applicable to 1985 and subsequent taxation

years,[141] to permit a limited amount of political activity by charitable foundations[142] and charitable organizations.[143] However, the following fundamental restrictions are placed on such activities:

(1) they must be "ancillary and incidental" to the charitable purposes; and

(2) they must not include "direct or indirect support of, or opposition to, any political party or candidate for political office".[144]

Thus, in essence, charities are permitted to carry on a limited amount of nonpartisan lobbying for the purposes of furthering their overall charitable objectives.[145]

It is important to note, however, that expenditures for such activities will not qualify for the disbursement requirements contained in section 149.1. Consequently, such activities must, in effect, be paid out of the administrative budget of the corporation (which is, in very general terms, limited to 20 per cent of the receipted donations of the charity). If the directors or officers of a charitable corporation permit a corporation to carry on unauthorized political activities, this would presumably be a breach of their duty and might, in some circumstances, constitute an offence under the relevant electoral laws.

Lobbying Activities

Any lobbying activity carried on by a charitable or nonprofit corporation with an agency of the federal government must comply with the provisions of the *Lobbyists Registration Act*.[146] Lobbying activities covered by the statute are very broadly defined. Section 5 of the *Act* relates to what are known as Consultant Lobbyists. Consultant Lobbyists are individuals[147] who, on behalf of any person or organization, undertake for payment of any kind to communicate with a public office holder in an attempt to influence the development of any legislative proposal; the introduction, passage, defeat or amendment of any legislation or resolution of Parliament; the making or amendment of any regulation; the development of any policy or program of the Government of Canada; the awarding of any grant, contribution or other financial benefit by or on behalf of Her Majesty in right of Canada; the awarding of any contract by or on behalf of Her Majesty in right of Canada; or the arranging of a meeting between a public office holder and any other person. Every such individual must file an information return with the registrar appointed under the *Lobbyists Registration Act* within 10 days after entering into that undertaking.[148]

In-House Lobbyists (Corporate) are employees[149] of a person, a significant part of whose duties as employees are to communicate with public office holders on behalf of the employer (or, where the employer is a corporation, on behalf of any subsidiary of the employer or any corporation of which the employer is a subsidiary) in an attempt to influence the development of any legislative proposal; the introduction, passage, defeat, or amendment of any legislation or resolution of Parliament; the making or amendment of any

regulation; the development or amendment of any policy or program of the Government of Canada; or the awarding of any grant, contribution or other financial benefit by or on behalf of Her Majesty in right of Canada. Employees must file an information return with the registrar: (i) within two months after the date on which those duties commence to be a significant part of their duties; and (ii) within two months after the end of each financial year of the employer or, if the employer does not have a financial year, within two months after the end of each calendar year, beginning with the financial or calendar year that the employee was first required to file a return.[150]

In-House Lobbyists (Organizations) are employees[151] of an organization that employs one or more individuals any part of whose duties is to communicate with public office holders on behalf of the organization in an attempt to influence the development of any legislative proposal; the introduction, passage, defeat, or amendment of any legislation or resolution of Parliament; the making or amendment of any regulation; the development or amendment of any policy or program of the Government of Canada; or the awarding of any grant, contribution or other financial benefit by or on behalf of Her Majesty in right of Canada. "Organization" is defined in s. 2(1) to include "a corporation without share capital incorporated to pursue, without financial gain to its members, objects of a national, provincial, patriotic, religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character or other similar objects." This is broad enough to cover both charitable corporations and noncharitable, nonprofit corporations. If these duties constitute a significant part of the duties of one employee or if the duties would constitute a significant part of the duties of one employee were those duties to be performed by only one employee, the senior officer[152] of the organization must file an information return with the registrar within two months after the date on which the organization first employs such an individual, and thereafter within 30 days after the expiration of each six month period after the date of filing.[153]

It is important to note that the *Act* does not apply in the following situations: (a) in respect of any oral or written submission to a committee of the Senate or the House of Commons or of both Houses of Parliament or to any body or person having jurisdiction or powers conferred by or under an Act of Parliament, where the proceedings are a matter of public record;[154] (b) to any oral or written submission made to a public office holder by an individual on behalf of any person or organization with respect to the enforcement, interpretation or application of any Act of Parliament or regulation thereunder by that public office holder and with respect to that person or organization;[155] or (c) to any oral or written submission made to a public office holder by an individual on behalf of any person or organization in direct response to a written request from a public office holder, for advice or comment in respect of any matter referred to in the listed provisions of the *Act*.[156] Finally, the statute does not require

disclosure of the name or identity of any individual where that disclosure could reasonably be expected to threaten the safety of that individual.[157]

In the case of lobbying activity by charitable and nonprofit corporations, the principal concern of directors should be to ensure that, where the organization employs staff members who would qualify as In-House Lobbyists (Organizations), the senior officer of the organization files, within the prescribed time frame, an information return containing the prescribed information. Failure by any individual to comply with any provision of the *Lobbyists Registration Act* constitutes an offence, which carries a maximum fine of $100,000 and up to two years' imprisonment.[158]

Therefore, the senior officer of a nonprofit or charitable corporation can, of course, be held liable for his or her failure to make the required filings under the statute. In addition, while there is no direct liability imposed on individual directors under this statute, a director who is also a paid employee and who lobbies on behalf of the corporation as a significant part of his or her duties would be individually subject to these filing requirements and sanctions.

Gambling Activities

Many charitable organizations rely, to one extent or another, on bingos and other games of chance to finance their activities. It is essential in this context to bear in mind that virtually all forms of gambling are offences under Part VII of the *Criminal Code*.[159] Paragraph 207(l)(b) of that statute permits the Lieutenant Governor in Council of a province (or such other person or authority in the province as may be specified by the Lieutenant Governor in Council) to license a charitable or religious organization to conduct and manage a lottery scheme "if the proceeds from the lottery scheme are used for a charitable or religious object or purpose." For these purposes, subsection 207(4) defines "lottery scheme" extremely broadly; it would include most forms of gambling, other than dice games, three-card monte, punch board, coin table, bookmaking, and games operated on or through a computer, video device or slot machine. In Ontario, licences are issued by local municipalities or by the Entertainment Standards Branch of the Ministry of Consumer and Business Services.[160]

Failure on the part of a corporation to obtain such a licence, or failure to abide by the terms of the licence, could give rise to a prosecution of the corporation, its directors and officers under Part VII of the *Criminal Code*.

Risk Management

An excellent summary of risk management is found in *Directors' Duties in Canada: Managing Risk*.[161] Notwithstanding that the book deals with risk management in the context of business corporations, these are sound principles of equal application to non-share capital corporations. The book outlines several approaches to diligence that directors can take in order to best protect themselves against liability. These include being familiar with the corporation

and how the board functions and having the tools to supervise and manage the corporation. The authors point out that risk management also means that the directors must fulfil their duties, including the duty of loyalty and the duty of care, in carrying out their responsibilities.[162] They also suggest that risk management should not be seen merely as a negative activity to prevent prosecution for an offence or a finding of liability but as a positive opportunity to improve the overall management of the corporation. Good risk management, they note, can enhance the corporation's reputation, as well as produce better working conditions and increase information for management and board decision-making.[163]

The following is a brief outline of the risk management approaches the authors suggest.

1. Directors must be familiar with how the corporation and the board function.
    - Directors should understand both their own legal obligations and those of the corporation.
    - Directors should be familiar with the corporation's operations and business affairs.
    - Directors should be familiar with how the board functions.
2. Directors must have the tools to supervise and manage.
    - Directors should establish regular information-reporting systems.
    - Directors should ensure that they have confidence in management.
3. Directors must fulfil their duties.
    - Directors should always remember their duty of loyalty to the corporation.
    - Directors should carry out their functions diligently, including documentation of their activities.
    - Directors should maintain their independence of mind.
4. Directors must communicate their goals and expectations.

5. Directors should establish and maintain regulatory compliance systems and reporting procedures.

Checklist for Directors' Decision-Making

As a practical matter it may be virtually impossible for volunteer directors to constantly keep in mind the various types of duties and responsibilities imposed upon them by virtue of their office. Nevertheless, it may be helpful to think of these duties and responsibilities in the form of a step-by-step code. Lisa A. Runquist[164] has advanced a form of checklist for directors of charitable and nonprofit corporations to assist in determining whether corporate decisions accord with their duties as directors. Although the list is extremely long, and

perhaps too exhaustive to put into play in all but the most critical corporate decisions, it may provide a helpful reference for corporate directors:

- What are the stated purposes of the organization?
- Does the transaction advance the stated purposes?
- Does the transaction benefit a private individual?
- Were any promises made when the funds were raised?
- Were any conditions placed on donated funds?
- Does the director attend the meetings?
- Are meetings held regularly?
- Does the director have all the relevant facts?
- Is there any reason not to trust the information being furnished?
- Are taxes being paid?
- Is there a conflict of interest or self-dealing?
- Is the transaction fair to the organization?
- How would an ordinarily reasonable and prudent person decide the matter?
- Are there other laws that affect the particular situation?
- How accurate are the records?
- Is the director acting honestly, in good faith, and with total integrity?
- Is this transaction in the best interests of the organization?

While the foregoing checklist is derived from American experience, it would probably be difficult for Canadian directors of a charitable or nonprofit organization to go wrong if they followed the spirit, if not the letter, of these prescriptions.

NOTES

1. The authors wish to thank Paola Calce, Fraser Milner Casgrain LLP, Student-at-Law, for her research work and contributions in updating this article and Kristi Kasper, Fraser Milner Casgrain LLP, summer student, for creating a summary of the article. An earlier version of this article was published in two parts in the *Estates and Trusts Journal*: William I. Innes, "Liability of Directors and Officers of Charitable and Non-Profit Corporations," Vol. 1 (1993) 13 E. & T.J. 1 and 151.
2. This article concentrates on the position of officers and directors of charitable and nonprofit corporations under the laws of the Province of Ontario and the laws of Canada, having general application within the Province of Ontario. Reference is made to certain other Canadian jurisdictions, but no attempt is made to provide a detailed analysis of the laws of any jurisdiction other than Ontario.
3. In the interests of brevity, this article does not attempt, except in passing, to comment on the potential liability of directors, officers or trustees of trusts, unincorporated associations or similar structures.

4. It is, as yet, unclear to what extent the PGT would extend its position on the responsibilities of directors and officers of charitable corporations to the directors and officers of non-charitable, nonprofit entities. This issue will be examined later in the context of the purpose and effect of the *Charities Accounting Act*, R.S.O. 1990, c. C. 10 and the *Charitable Gifts Act*, R.S.O. 1990, c. C. 8.
5. Public Guardian and Trustee for Ontario, "Submissions to the Ontario Law Reform Commission: Project on the Law of Charities", Vol. 10 (1990–91) E. & T .J. 272 [hereinafter PGT Law Reform Submissions]. It is not entirely certain to what extent the PGT still holds this position. The PGT's Charities Bulletin #3: *Duties, Responsibilities and Powers of Directors and Trustees of Charities* (last modified: January 21, 2000) [hereinafter "PGT Bulletin #3], however, provides some indication of that body's current view of the matter. In that document, the PGT lumps directors and trustees of charities together, to some extent, by stating that such persons "are sometimes referred to as charitable fiduciaries", and by generally making no distinction between the duties owed by trustees and the duties owed by directors of charitable corporations.
6. In the PGT Law Reform Submissions, *supra* note 5 at 280, the PGT cited some "35,000-plus" charities in Ontario, presumably at the time of publication in 1990.
7. Industry Canada, Corporate and Insolvency Law Policy Directorate, "Reform of the Canada *Corporations Act*, Draft Framework for a New *Not-for-Profit Corporations Act*" (March 2002) [hereinafter Reform Draft Framework]. See also Industry Canada, Corporate and Insolvency Law Policy Directorate, "A Supplement to the Draft Framework for a New *Not-for-Profit Corporations Act*" (March 2002) [hereinafter Reform Draft Framework Supplement].
8. *Supra*. Essentially, under Part IX of the proposed *Act*, directors would have a duty to act honestly and in good faith, for the best interests of the corporation and would be required to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
9. In view of the vast array of statutory material touching upon the liability of directors and officers of corporations, this article is intended as illustrative and not exhaustive. It would be almost impossible to list all of the provincial and federal legislation that might, in specific circumstances, impose liability, whether civil or criminal, upon the directors or officers of a corporation. Moreover, in the authors' view, such a compilation would be of little practical value.
10. R.S.O. 1990, c. C.38. This article will not deal with the special case of corporations incorporated by a public or private Act of the legislature or special purpose corporations such as public hospitals, except where cases dealing with these types of corporations state principles of general application: see, e.g., *Centenary Hospital Assn. (Re)* (1989), 59 D.L.R. (4th) 449, 69 O.R. (2d) 1 (H.C.), supp. reasons 60 D.L.R. (4th) 768, 69 O.R. (2d) 447 (H.C.).
11. Donald J. Bourgeois, *The Law of Charitable and Nonprofit Organizations* (Toronto: Butterworths, 1990) at 31. While it is true that a grant of letters patent has historically been viewed as a matter of Crown prerogative and, unlike the case under the *Business Corporations Act*, R.S.O. 1990, c. B. 16, there is no right, as such, to incorporation under letters patent statutes, it is questionable whether this arrangement is an authorized and appropriate exercise of the discretion of the Minister of Consumer and Business Services.
12. Public Guardian and Trustee, Charities Bulletin #2: *Information from the Public Guardian and Trustee's Charitable Property Program* (last modified: January 21, 2000).

13. s. 117. The *Corporations Act* does not apply to a corporation governed by the *Business Corporations Act* or to a corporation incorporated for the construction and working of a railway, incline railway or street railway.

14. ss. 286(4).

15. ss. 286(5).

16. Subsection 286(2) permits a director to become a member of a corporation within 10 days of his election or appointment to the board. Subsection 286(3) permits a corporation that is a public hospital or a recognized stock exchange to have directors that are not members of the corporation. In addition, section 127 provides, subject to the provisions of section 286, that the letters patent, supplementary letters patent or bylaws of a corporation may provide for persons becoming directors *ex officio* in lieu of election.

17. ss. 1(1). It is questionable whether such notice is necessary in the case of a corporation incorporated under the provisions of the *Corporations Act* since the PGT now must pre-approve all applications for incorporation, except those made pursuant to the new "streamlined" approach (where standardized pre-approved objects clauses are used).

18. ss. 2(1). Several years ago, the PGT published a notice to all charities and other *persons* that are subject to the provisions of *the Charitable Gifts Act* requiring an annual filing of accounts. The question is whether such a notice is authorized by the statute or whether the statute requires a case-by-case exercise of the PGT's discretion. In any event, the prudent course is probably to make such annual filings until the matter is clarified.

19. ss. 8(1). In essence, this provision is designed to prevent land-banking by charities and corresponds roughly with previous mortmain legislation. Section 7 defines "charitable purpose" as follows:

    "charitable purpose" means,
    (a) the relief of poverty,
    (b) education,
    (c) the advancement of religion, and
    (d) any purpose beneficial to the community, not falling under clause (a), (b) or (c);

    In addition, it defines "land" as follows:

    "land" includes an interest in land other than an interest in land held as security for a debt.

20. It is beyond the scope of this article to attempt to delineate the distinctions between charitable and non-charitable objects and activities. In very general terms, charitable objects fall into one of the four classes of charity originally codified in the *Statute of Elizabeth 1601 (Statute of Charitable Uses*, 43 Eliz. 1, c. 4), and subsequently expanded upon in a great deal of case law, culminating in the famous decision of the House of Lords in *Commissioners for Special Purposes of Income Tax v. Pemsel*, [1891] A.C. 531 (H.L.). This case was adopted in Canada in *Native Communications Society of British Columbia v. Canada*, [1986] 3 F.C. 471 (F.C.A.). As a result, there are now four recognized categories of charitable objects:

    1. the relief of poverty;
    2. the advancement of education;
    3. the advancement of religion; and
    4. objects for the general benefit of the community, not falling within one of the first three headings.

The three former categories have, notwithstanding their broad descriptions, been relatively narrowly construed. The courts have been very reluctant to expand the fourth category, insisting that any reform would have to be undertaken by legislation. In *Vancouver Society of Immigrant and Visible Minority Women v. Canada (Minister of National Revenue*), [1999] 1 S.C.R. 10, the Supreme Court of Canada held that fitting into the fourth category requires more than simply demonstrating a "public benefit" as that term is normally used; instead, the purpose must be beneficial in a way the law regards as charitable. In determining whether this last element is met, the Supreme Court stated that, among other things, the purpose in question must benefit the community or an appreciably important class of the community, and not be for mere private advantage. All of the categories share a requirement of benefit to the public as a whole; thus, an otherwise charitable object that was confined to a narrow group might not be regarded as charitable. It is often a very difficult question of law whether a particular object or activity is charitable. Directors and officers should take legal advice on such points and not attempt to make such decisions on their own. Common sense often has little to do with whether a particular object or activity will be regarded as charitable at common law. [See generally, D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984), pp. 550 et seq.]. Nonprofit organizations are those that are not charitable and, hence, not in a position to provide tax receipts to donors under *the ITA*, but are nevertheless exempt from tax under Part I of that statute on the basis that they are within the provision of section 149(1)(l):

> (l) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or otherwise available for the personal benefit of any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society or association the primary purpose of which was the promotion of amateur athletics in Canada;

It can be seen that some of such organizations will be dedicated to philanthropic, but non-charitable, activities. An example would be a group incorporated solely for the purpose of lobbying for political change to promote the rights of disadvantaged persons. Others can be of a purely social character, such as a golf club. The latter category of nonprofit organizations are generally analogous to clubs, and this article, when dealing with non-charitable, nonprofit organizations, generally concentrates on the former category.

21. R.S.O. 1990, c. C.8, ss. 2(1). The provision does not apply to an interest in a business given to or vested in "any organization of any religious denomination": ss. 2(2).
22. It is not clear whether the statute is confined to businesses carried on in Ontario. If it were not, there might be a constitutional question as to the efficacy of such a prohibition.
23. The misleadingly named *Charitable Institutions Act*, R.S.O. 1990, c. C.9, deals exclusively with certain charitable institutions "all or part of a building or buildings maintained and operated by an approved corporation for persons requiring residential, sheltered, specialized or group care" other than separately regulated institutions such as public hospitals: s. 1.
24. PGT Law Reform Submissions, *supra* note 5.
25. *Ibid.* at 277.
26. The content of PGT Charities Bulletin #3, *supra* note 5, in large part seems to affirm this point.

27. E.J. Mocker, "Charitable Corporations: A Bastardy Legal Form", *Canadian Bar Association Papers, 1966* (Canadian Bar Association), pp. 229–49.
28. W.F. Fratcher, ed., *Scott on Trusts*, 4th ed. (Boston: Little, Brown & Co., 1989) vol. IVA at §348.1, pp. 23–25.
29. R.S.O. 1990, c. T. 23.
30. L.S. Sealy, "The Director as Trustee" (1967) 83 Camb. L.J. 85–86.
31. *David Feldman Charitable Foundation (Re)* (1987), 58 O.R. (2d) 626, 26 E.T.R. 86 (Surr. Ct.); *Public Guardian and Trustee v. Toronto Humane Society* (1987), 40 D.L.R. (4th) 111, 60 O.R. (2d) 236 (H.C.J.).
32. *French Protestant Hospital v. Attorney-General (1951)*, 1 All E.R. 938 (Ch. D.). A very early decision on the point, *Charitable Corporation v. Sutton* (1742), 2 Atk. 400, 26 E.R. 642, is subject to the infirmities pointed out by Sealy.
33. See e.g., Maurice C. Cullity, "Case Comment In the Matter of the Application of The Canadian Foundation for Youth Action" (1977) 2(1) *The Philanthropist* 41; Maurice C. Cullity, "Case Comment: In the Matter of The Toronto Humane Society, the David Feldman Charitable Foundation" (1989) 4 *The Philanthropist* 12; David R. Foster & Lara C. Johnson, "Responsibilities and Duties of Directors of Nonprofit Corporations – Liability of the Nonprofit Director" *American Bar Association, Section of Business Law, Annual Meeting & San Francisco, California*, August 8–10, 1992; J.D. Gibson, "Liability of Directors of Ontario Charitable Corporations" (1979–81), 5 E. & T. Q. 71; John M. Hodgson & Anne C. McNeely, "Directors and Trustees: The Charitable Corporation and Trusteeship", *The Charitable Mosaic* (The Canadian Bar Association-Ontario. Dept. Continuing Legal Education, Looseleaf, Seminar, September 27, 1983); John M. Hodgson, Q.C. & David Allen, "Liability of Directors of Nonshare Capital Corporations", Continuing Legal Education, *Nonshare Capital Corporations* (Toronto: Canadian Bar Association-Ontario, 1986).
34. See "Selected New Developments in the Liability of Directors and Officers of Charitable and Nonprofit Corporations" in *The Philanthropist*, no. 18, vol. 3, for discussion of this case.
35. William I. Innes, *Tax Evasion in Canada* (Toronto: Carswell, 1987) at 81 *et seq.*
36. The latter provision specifically extends liability to the directors and officers of a corporation where they authorize, permit or acquiesce in the sale or offer for sale of such lists.
37. This provision is specifically applicable to nonprofit and charitable corporations incorporated under Part III of the statute by virtue of subsection 133(1).
38. One of the many practical risks involved here is that it is not uncommon for individuals to believe that they have resigned as directors and later find out that, in law, they remain directors. This issue has come up repeatedly in cases under the withholding tax provisions of the *ITA*.
39. Paras. 149(1)(f) and (l), respectively.
40. And of the *Income Tax Regulations*, C.R.C. 1978, c. 945 and in particular ss. 3500 through 3504 dealing with the contents of donation receipts and ss. 3700 through 3702 dealing with the disbursement requirements of charitable foundations.
41. Para. 150(1)(a), in the case of nonprofit organizations that are corporations.
42. s. 153.
43. Part XIII of the *Act*.

44. Section 227.1 was added by 1980-81-82-83, c. 140, s. 124, applicable with respect to amounts required to be deducted and remitted, or withheld and remitted, after November 12, 1981.
45. It is beyond the scope of this article to engage in an analysis of this issue. For applicable principles see the following cases: *The Queen v. Kalef*, 96 D.T.C. 6132 (F.C.A.); *Corsano*, (2001), 39 E.T.R. (2d) 96, [2001] O.J. No. 2170 (S.C.J.), online: QL (OJ); *McDougall v. The Queen* (2000), [2001] D.T.C. 1 (T.C.C.).
46. Even nonprofit social clubs such as golf courses may be involved in such cases.
47. See e.g., *R.* v. *Bata Industries Ltd.*, (1991), 70 C.C.C. (3d) 391 (Ont. Ct. (Pro. Div.)).
48. S.C. 1999, c.33.
49. s. 280(2).
50. ss. 280(1).
51. R.S.C. 1985, c. C-46, ss. 220 and 221 (applicable by virtue of S.C. 1999, c. 33, ss. 274(2).
52. R.S.O. 1990, c. E.19.
53. s. 194.
54. R.S.O. 1990, c. P.11, s. 49.
55. R.S.O. 1990, c. 0.40, s. 116.
56. ss. 99(2).
57. Part XIV, ss. 146–55.
58. R.S.C. 1985, c. E-15. The GST is imposed under Part IX of this statute.
59. P.C. 1990-2746, December 19, 1990, SOR/90-938-01.
60. In the case of most charities.
61. In the case of "hospital authorities."
62. s. 326.
63. s. 327.
64. s. 330.
65. Subsections 222(1), (3) and (4) were amended by S.C. 2000, c. 30, s. 50 and were proclaimed into force on October 20, 2000.
66. S.O. 2000, c. 41.
67. s. 80(2)
68. s. 80(4).
69. s. 81.
70. s. 136.
71. ss. 137(1).
72. ss. 137(2).
73. R.S.O. 1990, c. P.8.
74. ss. 110(2).
75. ss. 110(4).
76. ss. 110(3).

77. R.S.O. 1990, c. E.11.

78. s. 36.

79. R.S.O. 1990, c. O.1.

80. s. 32. See also ss. 66(4).

81. ss. 66(1).

82. For further discussions on the duties, responsibilities and liabilities of directors see: R.J. Burke-Robertson and A.B.C. Drache, Q.C., *Duties and Liabilities of Directors in Nonshare Capital Corporations* (Scarborough: Carswell, 1998); W. Gale, "Responsibilities and Liabilities of Directors of Not-for-Profit Corporations" (*Seminar on Not-for-Profit Corporations*, The Law Society of Upper Canada, Continuing Legal Education, 6 May 1993).

83. R.S.O. 1990, c. B. 16, s. 134.

84. It should be noted, however, that subsections 13(1) and (2) of the *Public Hospitals Act*, R.S.O. 1990, c. P.40, provide:

    Protection from liability

    13.(1) No action or other proceeding for damages or otherwise shall be instituted against any member of a committee of the medical staff of a hospital or of a board or of the staff thereof for any act done in good faith in the execution or intended execution of any duty or authority under this *Act* or the regulations or for any alleged neglect or default in the execution in good faith of any such duty or authority.

    (2) No action or other proceeding for damages or otherwise shall be instituted against any witness in a proceeding or investigation before a committee of the medical staff of a hospital or a board or the Appeal Board for anything done or said in good faith in the course of a meeting, proceeding, investigation or other business of such committee or board.

    There does not appear to be any law on this provision and as the precise ambit of the protection that it provides to hospital directors is unclear, it appears to be directed primarily at actions rather than negligent omissions.

85. [1925] 1 Ch. 407 (C.A.) at 428–29.

86. Although the same difficulty is found under the general law of negligence whenever a court is called upon to assess the culpability of joint tortfeasors.

87. In addition, as discussed later, some charitable and nonprofit corporations do carry on limited forms of business activity to support or enhance their charitable objects.

88. s. 71, made applicable to Part III corporations by subsection 133(1).

89. The declaration must be made at a meeting of the directors at which the question of entering into the contract is first taken into consideration or, if the director is not then interested in the contract, at the next meeting after he or she becomes so interested: ss. 71(2). A general notice to the directors of the corporation that a director is a shareholder of, or otherwise interested in, any company or a member of a specified firm, is deemed to be reasonable notice, so long as the director takes reasonable steps to ensure that the notice is brought up and read at the next meeting of the directors after it is given: ss. 71(3).

90. ss. 71(4).

91. ss. 71(5).

92. ss. 71(6).

93. (1973), 40 D.L.R. (3d) 371, [1974] 1 S.C.R. 592 [hereinafter *Canadian Aero Service* cited to S.C.R.].

94. *Ibid.* at 620, *per* Laskin J.

95. (1987), 39 D.L.R. (4th) 684, 14 B.C.L.R. (2d) 385 (B.C.S.C.).

96. para. 149(1)(l).

97. ss. 149.1(1) "charitable foundation"; ss. 149.1(1) "charitable organization."

98. Oddly enough, the prohibition does not extend to capital. In the case of nonprofit, non-charitable corporations, the CRA permits the transfer of remaining capital to members on a winding-up: M.N.R., *Interpretation Bulletin* IT-409, "Winding up of a nonprofit organization" (27 February 1978) at paras. 4, 10. In the case of charitable corporations, this would in most cases, if not all, be effectively prohibited by the tax imposed on a deregistered charity under subsection 188(1) and by the rule contained in subsection 188(2) whereby a transferee of property for less than fair market value is jointly and severally liable for the shortfall.

99. With the exception provided in subsection 286(3) of the *Corporations Act* permitting non-member directors in the case of public hospitals and recognized stock exchanges.

100. M.N.R., *Interpretation Bulletin* IT-496R, "Nonprofit Organizations" (2 August 2001) at para. 12; M.N.R., *Information Circular* 80-10R, "Registered Charities: Operating a Registered Charity" (17 December 1985) at para. 47(a).

101. *Public Guardian and Trustee v. Toronto Humane Society* (1987), 40 D.L.R. (4th) 111, 60 O.R. (2d) 236 (H.C.J.).

102. *Harold G. Fox Education Fund v. Public Guardian and Trustee* (1989), 69 O.R. (2d) 742, 34 E.T.R. 113 (H.C.J.), supp. reasons O.R. loc. cit., p. 748, E.T.R. *loc. cit.*, p. 120.

103. PGT Bulletin #3, *supra* note 5 at para. 5.

104. It should be noted, however, that subsection 126(2) of the *Corporations Act* expressly permits Part III corporations to pay reasonable remuneration and expenses to directors for acting as such and for services rendered in any other capacity, unless the letters patent, supplementary letters patent or bylaws provide otherwise.

105. PGT Bulletin #3, *supra* note 5 at para. 5.

106. R.J. Burke-Robertson and A.B.C. Drache, Q.C., *supra* note 82.

107. ss. 291(1).

108. ss. 289(1).

109. ss. 289(2).

110. ss. 289(3).

111. *Ibid.* at 5–15 and 5–16.

112. *Ibid.* at 5–17.

113. ss. 194(1).

114. ss. 194(2).

115. ss. 194(3).

116. s. 242.

117. Apart, that is, from any specific restrictions found in their letters patent, supplementary letters patent or bylaws.

118. It should also be noted that the *ITA* prohibits, in paras. 149.1(3)(c) and 149.1(4)(c), public and private foundations, respectively, from acquiring control of any corporation after June 1, 1950. Section 149.1(12)(a) provides rules for determining whether control has been acquired by a foundation, or by a foundation and a group with which it does not deal at arm's length, and provides an exception where not more than five per cent of the issued shares of any class were purchased or otherwise acquired for consideration.

119. S.O. 1998, c. 18, Sch. B., s. 16. In force July 1, 1999.

120. ss. 27(2).

121. ss. 27(1).

122. s. 28.

123. ss. 27(9).

124. Para. 149.1(3)(d).

125. Para. 149.1(4)(d).

126. In addition, in respect of a debt owing to a registered charity that is a private foundation, there is a special tax payable by the borrower under s. 189 of the *ITA* where the debt was a non-qualified investment of the foundation.

127. It is, of course, possible for an express charitable trust to have explicit powers permitting the trustee to borrow and pledge the assets of the trust as security.

128. Para. 149.1(4)(a).

129. Para. 149.1(2)(a).

130. Para. 149.1 (3)(a).

131. The term "substantially all", when it is used in the *ITA*, is generally interpreted to mean 90 per cent or more.

132. [1987] 3 F.C. 286, 87 D.T.C. 5306 (F.C.A.), leave to appeal to the Supreme Court of Canada denied on January 28, 1988, [1988] 1 S.C.R. xiii; (1988), 87 N.R. 397n.

133. This position seems to be in line with the CRA's position, which has clearly rejected a "destination-of-funds test," which would allow a charity to carry on any type of business, as long as the profits from the business were used to conduct charitable programs. In fact, the CRA will only apply this decision to situations with a similar fact pattern to that considered by the court in the case. In the CRA's view, the key decision of the court was that the conversion of donated goods to cash should not be characterized as a business. The CRA also hung its hat on statements made in the minority judgment that the related business provisions should be interpreted as dealing with those types of business that charities can legally engage in, not whether the intention was to further a charity's purpose, or whether it was actually applied to these purposes.

134. *Supra* note 20.

135. It is important to note that the CRA's administrative policy in the form of *Interpretation Bulletins* and *Information Circulars* does not have the force or effect of law and reflects only the CRA's position regarding how it will interpret the law.

136. CRA, "Consultation on Proposed Policy, Guidelines for Registered Charities on Related Business" (Updated: May 22, 2002) at Part II, para. 5.

137. ss. 2(1).

138. R.S.O. 1990, c. C.8, s. 3.

139. Nonprofit corporations, like charities, must comply with the provisions of federal and provincial legislation governing elections and election financing. It is, for example, an offence under federal law to make a contribution to a political party otherwise than by payment to a registered agent of that party. (*Canada Elections Act*, R.S.C. 1985, c. E-2, ss. 36(2)). The chief agent of each registered party must make an annual return which, among other things, must set out the name of each corporation without share capital that donates more than $100, including loans, advances, deposits, contributions and gifts (para. 44(2)(b)).

140. *Nat. Anti-Vivisection Soc. v. I.R.C.*, [1948] A.C. 31 (H.L.).

141. S.C. 1986, c. 6, ss. 85(2).

142. ss. 149.1(6.1).

143. ss. 149.1(6.2).

144. Paras. 149.1(6.1)(b), (c).

145. See e.g., M.N.R., *Information Circular* IC 87-1, "Registered charities – Ancillary and incidental political activities" (25 February 1987).

146. VR.S.C. 1985 c. 44 (4th Supp.), proclaimed in force September 30, 1989.

147. "Individuals" does not include employees in respect of anything they undertake to do on the sole behalf of their employers or, where the employer is a corporation, in respect of anything that the employee, at the direction of the employer, undertakes to do on behalf of any subsidiary of the employer or any corporation of which the employer is a subsidiary: ss. 5(6).

148. ss. 5(1).

149. For these purposes, "employee" includes an officer who is compensated for the performance of his or her duties: ss. 6(7).

150. ss. 6(2).

151. For these purposes, "employee" includes an officer who is compensated for the performance of his or her duties: ss. 7(6).

152. Defined in subsection 7(6) as the most senior officer of the organization who is compensated for the performance of his or her duties.

153. s. 7.

154. para. 4(2)(a).

155. para. 4(2)(b).

156. para. 4(2)(c).

157. ss. 4(3).

158. s. 14.

159. R.S.C. 1985, c. C-46.

160. Donald J. Bourgeois, *The Law of Charitable and Nonprofit Organizations* (Toronto: Butterworths, 1990) at 134.

161. M. Priest *et al*., (North York: CCH Canadian Limited, 1995).

162. *Ibid.* at 169.

163. *Ibid.* at 170.

164. "Responsibilities and Duties of Directors of Nonprofit Corporations – Corporate Issues" (*American Bar Association, Section of Business Law, Annual Meeting*, San Francisco, California, 8–10 August 1992) at 756–66. The reader may wish to consult this excellent article for a thorough analysis of the reasoning behind the various items set out in the following list.