# Case Comment

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> In The Matter of the application of The Canadian Foundation for Youth Action for the passing of its accounts for the period Aug. 17, 1973 to July 31, 1975. (Surrogate Court of the Judicial District of York, Cornish, J.-Reasons, January 25, 1977.)

A number of contributions to the first issue of this magazine were directed at methods of protecting charitable gifts and of supervising charitable organizations. Concern about the adequacy of existing controls in Canada provided part of the motivation for the establishment of the Special Committee on Charitable Organizations and of The Philanthropist itself. It would be an exaggeration to say that much has been achieved and, as yet, the committee can claim no success in stimulating legislative action or, indeed, any significant interest at the provincial government level. It is possible that a recent case which came before Judge Cornish in the Surrogate Court in Toronto will provide some of the impetus which is required if reform is to be achieved.

The case involved the Canadian Foundation for Youth Action, a body incorporated in September, 1973 with objects which included the following:

> (a) To be a charitable foundation for the purpose of raising funds to finance its remaining objects set forth below;
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> (b) To supply and render services of a charitable nature and employ its property, assets and rights for the purposes of promoting or aiding in the promotion of the welfare of underprivileged children;
>
> (c) To establish training and camping centres with a view to enabling underprivileged children to be exposed to healthful and uplifting associations and environments;
>
> (d) To co-operate with other organizations, whether incorporated or not, which have objects similar in whole or in part to the objects of the Corporation; . . .
>
> (f) To do all such other things as are incidental or conducive to the attainment of the above objects.

Over the next two years the directors of the C.F.Y.A. solicited and obtained donations and receipts amounting to at least $496,560. In March, 1974 the Public Trustee, acting under section 3 of *The Charities Accounting Act* R.S.O. 1970, Ch. 63, required the corporation to submit its accounts to be passed and audited by a judge of the Supreme Court. The audit was conducted by Judge Cornish on a number of days in 1975 and 1976 and his findings were delivered on January 25, 1977. These included the following:

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(a) Less than 10% of the total receipts had been disbursed for exclusively charitable purposes;

(b) The greater part of the disbursements were neither charitable nor within the objects of the corporation in that more than 60% of the receipts were spent on wages, salaries, bonuses, loans and advances to the directors and employees of the corporation;

(c) Some disbursements had never been recorded; and

(d) That the receipts were incomplete and that control over them had been inadequate.

In his reasons, His Honour considered at some length the existing methods of supervising and controlling charitable corporations in Ontario and expressed considerable dissatisfaction with the provisions of *The Charities Accounting Act*. These he said, "give the public only a cumbersome, lengthy and uncertain method of dealing with the actions of the directors of fund-raising charitable organizations like C.F.Y.A." He expressed his conviction that the provisions of the *Income Tax Act*, as administered by the Department of National Revenue "provide an inadequate method of controlling the disbursement of funds received by 'registered Canadian charitable organizations'." His Honour referred to the *Proposals for a new Not For Profit Corporations Law of Canada* which have been published by the Federal Department of Consumer and Corporate Affairs and commented as follows:

> "These proposals make excellent recommendations for the correction of weaknesses in the existing law but unfortunately they do not appear to cover the weaknesses in the law revealed in this audit. I refer particularly to control of the description of charitable objects in the letters patent and supervision subsequently of the use of funds received from donors."

He expressed similar doubts as to the effectiveness of *The Business Practices Act*, S.O. 1974, Ch. 131 as a means of preventing the misapplication or misappropriation of funds by charitable organizations. He concluded with a number of recommendations for the improvement of the existing "unsatisfactory state of the law relating to the supervision of charitable organizations:

1. The supervision of such charitable organizations as C.F.Y.A. requires constant supervision from the date they are incorporated or otherwise brought into existence.
2. The management of such organizations can involve both criminal and civil breaches of trust and the Ministry of the Attorney General is best suited to be responsible for such supervision.
3. Such supervision requires on the spot trained investigators supported by competent legal advisers.
4. Such supervision requires regular reporting of:
   (1) donations received

(2) salaries paid to directors and officers
(3) monies expended on strictly charitable activities
(4) administration expenditures
(5) income tax receipts issued
(6) bank statements

5. The most suitable government official to provide such supervision is the office of the Public Trustee of Ontario or possibly the Department of the Attorney General rather than the Department of National Revenue or the Department of Consumer and Corporate Affairs. It would not be a difficult matter for the provincial body to keep the Federal Departments suitably informed.

6. *The Charities Accounting Act* as it now stands is a cumbersome confusing statute which is completely ineffective for the curbing of such operations as C.F.Y.A. It is the Directors of the Corporation and not the corporation who should be the trustee of funds received from donors. This Act should either be drastically revised or the provisions for control of charitable organizations transferred to some other statute such as the Public Trustee Act.

7. The new statutory provisions should:
   (1) clarify the responsibility of directors of charitable organizations for mismanagement and misapplication of funds.
   (2) provide some guidelines as to what percentages of monies received from donors should be devoted to strictly charitable purposes and the administrative functions necessary to carry out such strictly charitable works. This percentage will obviously be smaller during the first year of a charitable organization's operations.

8. The supervising body should be given powers to inspect the charitable organization's whole operation including its books and receipt forms.

9. The inclusion of the word "Foundation" in the corporate name of a charitable organization suggests strongly to the public that some philanthropic or charitable person or corporation has "founded" the organization thus giving it prestige. This is obviously inapplicable to such organizations as C.F.Y.A. the sponsors of which put in no money and took a lot out of the receipts from the public.

10. A considerable increase in investigating staff and supporting personnel will be needed or the amending legislation will be of little use.

11. The accounting procedures of the Surrogate Courts of Ontario on the passing of accounts are not well-suited to investigating the accounts of fund-raising charitable organizations and amending legislation is required in this direction also.

12. If by amending legislation the directors are made trustees, then the provisions of Section 35 of the *Trustee Act* which protects trustees from certain breaches of trust will have to be revised to cope with the difficult task of deciding what is in fact a "charitable" expenditure.

13. Information about the accounts, management and operations of fund-raising charitable organizations should be made readily available to the public."

Part of His Honour's dissatisfaction with the existing law flowed from his conclusion that he had no power under *The Charities Accounting Act* or under any other statute to order that the directors of C.F.Y.A. should repay any money misapplied or misappropriated during their term of office. Section 4 of the Act does provide for sanctions to be applied against defaulting executors and trustees. These include attachment to the amount of the default and a fine or imprisonment for a term not exceeding twelve months. The jurisdiction to apply the sanctions is vested not in the Surrogate Court but in a judge of the Supreme Court in Chambers upon an application by the Public Trustee. This kind of division of jurisdiction is not uncommon and by itself it would be objectionable mainly on grounds of additional delay and expense. A much more disturbing fact is, however, the possible implication in His Honour's reasons that the sanctions cannot be applied to persons who are the directors of a charitable corporation.

The extent to which the general law which relates to charitable trusts is applicable to charitable corporations has never been exhaustively determined and in many important respects the position is very obscure.[1] There is a body of conflicting judicial dicta and in English law, prior to legislative intervention, the attitude of the courts appears to have varied from one period to another. Section 1 of *The Charities Accounting Act* attempts to deal with the problem by deeming a corporation incorporated for a religious, educational, charitable or public purpose to be a trustee within the meaning of the Act. Section 3 obliges a trustee to submit his accounts to a judge of the Surrogate Court if the Public Trustee so requires. Section 4 imposes sanctions with respect to "any such executor or trustee who . . . is found to have misapplied or misappropriated any property or fund coming into his hands". On a strict reading of the section it would seem possible to argue that the sanctions are applicable only to the corporation and not to its directors. If the argument is correct, the Act is seriously defective: by sheltering behind the corporate veil directors and officers can obtain immunity from the consequences which the statute attaches to the defaults of trustees. If this is indeed the position, there seems to be no good reason why the immunity should be thought to extend beyond the four corners of the Act.

The controversy as to the extent to which charitable corporations are to be treated as trustees under the general law should not be allowed to obscure the fact that there is a line of English authorities in which the Court of Chancery permitted the Attorney General to proceed against the officers of a chartered charitable corporation on the ground that they had misappropriated or misapplied charitable funds. In the earliest cases of which the first important one was probably the *Sutton Colefield Case*[2] in 1635, the jurisdiction was based simply on necessity. Long before that decision and before the *Statute of Elizabeth*[3] in 1601 the Court of Chancery had exercised jurisdiction over charitable trusts and charitable legacies and the notion of the Crown as the protector of charity can be traced back at least as far as the reign of King Henry VIII. However, despite at least one judicial dictum to the contrary,[4] the practice of the Attorney General to intervene on behalf of the Crown in matters of charity may not have commenced before the second half of the seventeenth century.[5]

The Attorney General was not involved in the *Sutton Colefield Case* which was concerned with the jurisdiction of the Commissioners appointed under the *Statute of Elizabeth*. It was held that a statutory provision which excluded their jurisdiction in any case in which special visitors of a charitable corporation were appointed did not apply if the visitors themselves had control over the revenues. With the decline in the practice of appointing commissioners, the same distinction was used in a number of cases to draw a line between those situations in which the Court of Chancery could intervene on an information brought by the Attorney General and those in which the visitatorial jurisdiction was supreme.[6] In *Attorney General* v. *The Governors of the Foundling Hospital,* Eyre, L.C. summarized the position as follows:

> "There is nothing better established, than that this court does not entertain general jurisdiction to regulate and control charities established by Charter. Where the establishment is fixed and determined the court has no power to vary it. If the Governors, established for the regulation of it, are not those who have the management of the revenue, this court has no jurisdiction; and if it is ever so much abused, as far as respects the jurisdiction of this court it is without remedy: *but if those, established as Governors, have also the management of the revenues, this Court does assume a jurisdiction of necessity, so far as they are to be considered as trustees of the revenue."* [7]

There was no retreat from this position in nineteenth-century English law. The reverse was the case. As the courts became increasingly disenchanted with the visitatorial jurisdiction – a tendency which must have been encouraged by the reports of the charity commissioners in the early years of the century – they gradually extended their jurisdiction to cases in which at an earlier period deference would probably have been paid to the function and powers of visitors. As a justification for their intervention judges ceased to speak of a jurisdiction of necessity and, instead, referred exclusively to the Court of Chancery's jurisdiction with respect to trusts.[8] In three decisions of Sir John Romilly, M.R.

in the middle of the century both the attitude of the court and the broad concept of a trust which was relied upon appears quite clearly:

> "The only remaining point, then, on this part of the case, is whether the jurisdiction of the court is taken away by reason of the visitorship of the Bishop of Winchester. If this were the law, it would be very unfortunate, for it does not require the history of this case to teach us that visitorships vested in anyone, whether a corporation sole or aggregate, or the heir of the founder, is a mere nominal office, duties of which are rarely spontaneously performed. But the law is not so. Where there is a clear and distinct trust this court administers and enforces it as much where there is a visitor as where there is none. This is clear both on principle and auhority. . . . *Green* v. *Rutherforth* and the case of the Birkhampstead School and several other cases, expressly establish the authority of this court in cases of trusts, and the duty of this court to see they are properly performed, notwithstanding that there may be a special or a general visitor." [9]

> "This court has authority to redress a breach of trust, where the objects of the founder have been prevented or neglected." [10]

> "With respect to the internal regulation and management of a charity, apart from any question of breach of trust, if the original founder of the charity has appointed a visitor for the purpose of seeing that certain parts of the internal regulation are carried into effect, this court does not interfere with the visitatorial power, unless it finds a breach of trust; that is something totally at variance with the views of the founder." [11]

Hand in hand with this change in emphasis went a change in judicial attitudes towards the historical basis of the court of chancery's jurisdiction with respect to charities. While in the older cases and treatises the tendency was to treat the court's jurisdiction as a specifically delegated branch of the royal prerogative,[12] in the nineteenth-century cases and in the more modern texts it is usually stated that the jurisdiction over charities is part of the general jurisdiction with respect to trusts.[13] Whether statements of either kind are accurate or meaningful is immaterial as long as such "history" is not used to provide a premise from which restrictions on the modern jurisdiction of the court can be deduced.

This change in the approved basis of the jurisdiction caused conceptual difficulties as the implications of the notion of corporate personality were worked out in the latter half of the nineteenth century. Whereas, in 1847, Lord St. Leonards appeared to be satisfied that any gift to a charitable corporation was a gift on trust for its objects[14] and although similar views were expressed by North, J. in 1890,[15] dicta to the contrary have been delivered in a number of later English,[16] Australian[17] and Canadian[18] cases. In the present state of the authorities it seems clear that charitable corporations like other corporations may hold property as beneficial owners free from any trust in the strict sense. Further, it seems that, although a gift to such a corporation for a specific

purpose will create such a trust, a gift for the general purposes of the body will normally be construed as a beneficial gift.[19]

In this area, as in most others, incorrect conclusions can be drawn if conceptualism is taken too far. In particular it is a mistake to assume that by characterizing a charitable corporation as a trustee or as a beneficial owner for some purposes, all the normal consequences of trusteeship or the normal incidents of beneficial ownership will necessarily exist. The fact is that a charitable corporation is, and has for some centuries been treated as, something of a hybrid.[20] It is subject to some of the rules relating to trusts and to other rules relating to non-charitable corporations. Professor Scott has described the position with his usual clarity:

> "The truth is that it cannot be stated dogmatically either that a charitable corporation is or that it is not a trustee. The question is in each case whether a rule which is applicable to trustees is applicable to charitable corporations, with respect to unrestricted or restricted property. Ordinarily the rules which 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."[21]

Relatively recent examples of the application to charitable corporations of principles derived from the law of charitable trusts can be found in the decision of the House of Lords in *Royal College of Surgeons* v. *National Provincial Bank,*[22] in that of Vaisey, J. in *Re Whitworth Art Gallery Trusts*[23] and in that of Danckwerts, J. in *Re French Protestant Hospital.*[24] In the last of the cases mentioned the reasoning of the learned judge is perfectly consistent with the earlier authorities on the position of the governors or officers of charitable corporations:

> "It is said by counsel for the applicants that it is the corporation which is trustee of the property of the charity in question, and that the applicants, the governor and directors, are not trustees. Technically that may be so. The property of the charity is, of course, vested in and held by the corporation. The corporation, however, exists only according to the rules of law, and it is not an actual person capable of acting on its own motion in any way whatever. It seems to me that in a case of this kind the court is bound to look at the real situation which exists. It is obvious that the corporation is completely controlled by the governor, deputy governor, and directors, and it is, therefore, those persons who, in fact, control the corporation and decide what shall be done. Those persons are as much in a fiduciary position as trustees in regard to any acts which are done in regard to the corporation and its property. It would be entirely illegal if they were simply to put the property, or the proceeds of the property of the corporation, in their pockets and make use of it for their own

> individual purposes or for their purposes as a whole, and not for the purposes of the charitable trust for which the property is held. Therefore, it seems to me plain that they are, to all intents and purposes, and for the purposes of this case, bound by the rules which affect trustees."[25]

It is submitted that, unless there exists in Ontario or in other common law provinces of Canada, legislation which abolishes the power of the Attorney General to call the officers of charitable corporations to account, the existence of that power is established by a line of decisions which can be traced back as far as the seventeenth century. It is submitted further that there is nothing in *The Charities Accounting Act* of Ontario which indicates an intention to abrogate or to interfere with the powers of the Attorney General. The statute creates machinery and confers powers on the Public Trustee. It does not appear to detract from those of the Attorney General. It is possible that the words of section 4 do not permit the application of the statutory sanctions to directors of charitable corporations on the motion of the Public Trustee. In view of the decisions which treat them as being fiduciaries or, in other words, as constructive trustees, such a conclusion does not seem to be inevitable. Even if it is correct there seems no reason to doubt that courts which have inherited the ancient jurisdiction of the Court of Chancery retain the residual power to call directors of charitable corporations to account at the instance of the Attorney General.

It would be difficult to read the reasons delivered by Judge Cornish without sharing his conviction that *The Charities Accounting Act* should be revised and that a more efficient system of supervising the expenditure of charitable funds should be introduced. His Honour's findings have received some publicity in the press and they must surely cause as much, if not more, disquiet among the vast majority of those who have the duty to administer charitable funds as they will among members of the public at large. It would seem to be in the best interests of neither that the present restrictions on the powers of the Public Trustee should be allowed to continue.

**Footnotes**

1. See the discussion by E. J. Mockler in *Charitable Corporations: A Bastard Legal Form,* (1966) C.B.A. Papers 229.
2. (1635) Duke 68.
3. 43 Eliz. I, c. 4.
4. *Eyre* v. *Countess of Shaftesbury* (1722), 2 P. Wms. 103, at p. 119 *per* Jekyll, M.R.
5. See Jones, *History of the Law of Charity 1532-1827* (Cambridge, 1969), at p. 21.
6. *Attorney General* v. *Middleton* (1751), 2 Ves. 327;
   *Attorney General* v. *Lock* (1744), 3 Atk. 164;
   *ex parte Kirby Ravensworth Hospital* (1805), 15 Ves. 305;
   *Attorney General* v. *Dixie* (1805), 13 Ves. 519.
7. (1793), 2 Ves. 42, et p. 47, (Italics added).
8. One of the earliest cases in which this appears was *ex parte Berkhampstead Free School* (1813), 2 Ves. & B. 134.
9. *Attorney General* v. *St. Cross Hospital* (1835), 17 Beav. 435, at p. 466.
10. *Attorney General* v. *The Sherborne Grammar School* (1854), 18 Beav. 256, at p. 280.

11. *Attorney General* v. *The Dedham School* (1857), 23 Beav. 350. at p. 356.
12. See the discussion by Marshall C. J. in *Philadelphia Baptist Association* v. *Hart's Executors* (1819), 17 U.S. 1, at p. 47 and the authorities cited there.
13. *Attorney General* v. *Brown* (1818), 1 Swan. 265; *Tudor on Charities* (6th ed. 1967, at p. 302.
14. *Incorporated Society* v. *Richards* (1841), 1 Dr. & W. 258.
15. *Re Manchester Royal Infirmary* (1890), 43 Ch. D. 420.
16. *Bowman* v. *Secular Society Ltd.*, [1917], A.C. 406; *Re Ogden*, [1933] Ch. 678.
17. *Sydney Homeopathic Hospital* v. *Turner* (1959-60), 102 C.L.R. 188.
18. *Re Delaney* (1958), 12 D.L.R. (2d) 23; *Re Schechter* (1964). 43 D.L.R. (2d) 417, (1966) 53 D.L.R. (2d) 577.
19. *Re Ogden, supra,* footnote 16; *Re Schechter, supra,* footnote 18.
20. See Mockler, *op. cit., supra,* footnote 1.
21. *Scott on Trusts* (3rd ed. 1967), at p. 2778.
22. [1952] A.C. 631 (perpetuities).
23. [1958] Ch. 461 (cy pres).
24. [1951] 1 All E.R. 938 (remuneration of directors).
25. *Ibid.*, at p. 940; See, also, *Bray* v. *Ford*, [1896] A.C. 44 (where the charity was a limited company).