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# Today's Presentation



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## Working with the CNCA – Tough issues

On July 26, 2012, Canada Revenue Agency (CRA) released Guidance CG-014, *Community Economic Development Activities and Charitable Registration* (the New Guidance).

Our presenter today is Ms. Theresa L.M. Man, partner of [Carters Professional Corporation](http://www.carters.ca).

## Questions?

- **Chat (Q&A) Pod:** Use the pod to the right of the slides, type in your question at the bottom.
- This session is scheduled to be one hour long. We will answer as many of your questions as we can towards the end of the presentation. Over to you, Ms. Man.

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**IMAGINE CANADA**  
Charity Tax Tools Webinar

May 7, 2013

**Working with the CNCA – Tough Issues**

**By Theresa L.M. Man**

tman@carters.ca

1-877-942-0001

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CARTERS PROFESSIONAL CORPORATION  
TOLL FREE: 1-877-942-0001

Ottawa Toronto Mississauga Orangeville  
[www.carters.ca](http://www.carters.ca) [www.charitylaw.ca](http://www.charitylaw.ca) [www.antiterrorismlaw.ca](http://www.antiterrorismlaw.ca)

## TOPICS FOR REVIEW

- Status of The *Canada Not-For-Profit Corporations Act* (“CNCA”)
- Overview of Continuance Process
- Understand the CNCA Framework
- Selections of Key Tough Issues
- For General Overview of CNCA Process – See Imagine Canada Webinar “CNCA: Continuance and More” on October 31 2012  
<http://charitytax.imaginecanada.ca/demand-webinars>

## A. STATUS OF THE CNCA

- *Canada Corporations Act* (“CCA”) not updated since 1917
- New CNCA enacted on June 23, 2009
- In force on October 17, 2011
- Replaced Part II of CCA
- Up to March 12, 2013, only 763 of approximately 17,000 corporations had continued

## RESOURCES

- Corporations Canada's website  
[http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h\\_cs03925.html](http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h_cs03925.html)
  - Transition Guide
  - How to operate under the CNCA
  - Model by-law and by-law builder
- Paper by Theresa Man "Working With The Canada Not-for-profit Corporations Act: Incorporation And Continuance" April 8, 2013  
<http://www.carters.ca/pub/article/charity/2013/tlm0408.pdf>
- *Charity Law Bulletins* on "Countdown to the Canada Not-For-Profit Corporations Act - Practice Tips" 1 to 9, Bulletin Nos. 191, 193, 199, 213, 215, 220, 231, 239, 247



## B. OVERVIEW OF CONTINUANCE PROCESS

- The new rules do not apply automatically to CCA corporations
- Existing CCA corporations will be required to continue under the CNCA within 3 years of proclamation - i.e., by October 17, 2014
- Failure to continue will result in dissolution of the corporation
- Can amend letters patent and by-laws prior to continuance under CCA
- Can amend letters patent and by-laws at the time of continuance

- All CCA corporations will need to
  - Review letters patent and by-laws
  - Prepare articles of continuance, notice and new by-law
  - Get membership approval
  - File articles and notice with Corporations Canada, no filing fee
  - Certificate of continuance will be issued
  - File approved new by-law within 12 months of adoption
  - Charities - send certificate of continuance, articles of continuance and new by-law to CRA

## C. UNDERSTAND THE CNCA FRAMEWORK

- Rules in the Act
- Details in the Regulations
  - “prescribed”
  - “regulations”
- Need to refer back and forth between the Act and the Regulations
- Articles
- By-laws
- Unanimous member agreement

- CNCA provides both a general framework and sets of rules for corporations to operate
- Three types of rules in CNCA
  - Mandatory Rules - Cannot be overridden by the articles or by-laws
  - Default Rules - By-laws or articles can override
  - Alternate Rules - Articles/ by-laws can include certain optional rules provided by CNCA

- Mandatory Rules
  - Rules that cannot be overridden by the articles or by-laws - examples
    - Directors are elected by members
    - Directors can be removed by majority vote of members (or by class vote)
    - Notice of meetings of members - must comply with the regulations
- Default Rules
  - Apply automatically where by-law/articles are silent - examples
    - Directors can borrow and grant security without members' authorization
    - A majority of members constitutes a quorum

- Alternate Rules
  - Optional rules that are provided by the CNCA - - examples
    - Consensus decision-making
    - Appointment of directors - (must be in articles)
  - Articles or by-laws must provide for these rules
- CNCA silent
  - Can include provisions on issues that the CNCA is silent - examples
    - Dispute resolution mechanisms
    - Stewardship provisions
    - Statement of faith
  - These provisions may be set out in the policies, by-laws or articles

## D. SOLICITING VS NON-SOLICITING

- Corporations that receive public funding are subject to special requirements
- All corporations categorized into soliciting and non-soliciting corporations
- If a corporation receives more than the prescribed amount [\$10,000] in its last financial period from public sources, it will become a soliciting corporation
- Status starts at the AGM in the following fiscal year for 3 years

- Public sources
  - (a) requests for donations or gifts person who are not
    - members, directors, officers, or employees of the corporation at the time of the request for donation or gifts
    - legal or common law spouse of the above persons
    - children, parents, brothers, sisters, grandparents, uncles, aunts, nephews or nieces of the above persons
  - (b) grants or other similar financial assistance received from the federal or a provincial or a municipal government, or agencies of such government
  - (c) donations or gifts received from a soliciting corporation



- Implications of being a soliciting corporation
  - Must have a minimum of 3 directors, at least 2 directors must not be officers or employees of the corporation or its affiliates
    - No material effect on registered charities due to prohibition on directors receiving remuneration at common law
  - Articles must provide for the distribution of remaining property on dissolution to qualified donees
  - No unanimous member agreement
  - Must file annual financial statements with Corporations Canada
  - Audit and public accountant rules more stringent

- Low threshold means many corporations will become soliciting corporations
- It is possible that some corporations could oscillate between soliciting and non-soliciting
- Corporations will need to monitor their funding sources and carefully track their soliciting status

- If a corporation is concerned about oscillation, it can voluntarily be structured as a soliciting corporation
  - Ensure at least 3 directors on the board and at least 2 are not employees (but charities cannot have any directors who are employees)
  - Ensure the articles provide that property will be paid to qualified donees on dissolution
  - Do not enter into unanimous member agreement
- For those years when it exceeds the \$10,000 threshold
  - File annual financial statements with Corporations Canada
  - Follow audit and public accountant rules for soliciting corporations - may not be an issue if the corporation's practice is to have its financial statement audited

## **E. MEMBERSHIP ISSUES**

### **1. Membership Class Votes – De Facto Veto Rights**

- A corporation must have members
- Articles to set out the classes of members
- If only one class of members, all are voting
- If two or more classes, articles must provide voting right to at least 1 class
- By-laws must set out the conditions for membership
- Where more than one class, the members of each class have certain built in protections

- Separate class votes - two types of matters
  - (i) Fundamental changes, such as
    - Amalgamation
    - Continuance
    - Sale, lease or exchange of all or substantially all of the property of a corporation other than in the ordinary course of its activities

- (ii) Changes of the rights attached to a class or group of members
  - a) exchange, reclassification or cancellation of all or part of the memberships of the class
  - b) add, change or remove the rights or conditions attached to the memberships of the class
  - c) increase the rights of any other class of members having rights equal or superior to those of the class
  - d) increase the rights of a class of members having rights inferior to those of the class to make them equal or superior
  - e) create a new class of members having rights equal or superior to those of the class
  - f) exchange or create a right of exchange of all or part of the membership of another class into the membership of the class
- Can prevent class votes under (a) and (e) by inserting a provision in the articles

- Regardless of whether the membership class is a voting class or non-voting class
- Thus a class of members could reject a change - effectively resulting in a class veto (limited opt-out available)
- The treatment of members mirrors that in the *Canada Business Corporations Act* in relation to shareholder's rights
- In most circumstances, giving non-voting members the right to vote on fundamental changes may not be desirable

- Common examples of having different membership classes
  - Members from different industry sectors
  - Members from different geographical regions
  - Members from different age groups
  - Founders
  - Broad-based community support, donors
  - Honorary members
  - Life members



- Considerations
  - What is the purpose of having multiple classes?
  - Is the corporation prepared to seek class approval (including the non-voting members) in future?
  - It is possible to group the voting members into one class of members?
  - Would the members be willing to restructure their membership status?
  - What is the likelihood of changing the membership structure or membership rights in any class in the future?
  - What is the likelihood of engaging in fundamental changes (such as amalgamating with another organization with similar visions/missions) in the future?

- Examples of possible options
  - Status quo - but corporation must be prepared to seek class votes in future when required by CNCA
  - Collapse all membership classes into 1 pool of voting members
  - Turn non-voting membership classes into non-membership categories
  - Turn non-voting members into a “designation” for a group of persons

- For example - collapse membership classes into one class and remove non-voting membership classes
  - If corporation wants broad-based community support, may enlist them in some capacity in the corporation, but do not refer to them as “members”
  - Change them into a non-membership category, such as “affiliates”, “associates”, “supporters”
  - May set out their rights and duties as non-members
  - Fee structure for members and non-members can be set out in policy
  - But their donations will not be exempt from the \$10,000 threshold

- Timing to collapse membership classes
  - If change membership rights as part of the continuance, then articles of continuance and by-laws also require separate class vote
  - Needs to change membership classes and rights by amending the by-laws under the CCA first, prior to continuance under the CNCA

## 2. Termination of Membership / Discipline

- If articles or by-laws gives the directors, the members, or a committee the power to discipline a member or terminate membership, then must also set out the circumstances and the manner in which a member may be disciplined or membership terminated
- CNCA does not set out minimum procedural threshold
- Case law suggests that organizations have a duty of fairness, including advising the affected member about the case and the process, and providing him/her an opportunity to be heard

- Statutory response to the courts' reluctance to intervene in the affairs of a voluntary relationship, and inadequate provisions in organizations' by-laws addressing this issue
- Fairness process required
- Including termination for objective reasons
  - Not meeting membership qualification requirements
  - Not paying membership dues

### 3. Members' Rights

- Members have extensive rights and remedies under the CNCA – examples
  - Right to requisition a meeting of members (5% of voting right, or lower if in the by-law)
  - Right to submit proposals to amend by-laws or require any matter to be discussed at annual meetings (any one member)
  - Right to submit proposal to nominate directors (5% of voting right)
  - Right to access corporate records, including membership list
  - Availability of unanimous members agreement (except for soliciting corporations)

- Oppression remedy against the corporation
- Court order to commence a derivative action
- Compliance and restraining orders
- Court ordered wind-up and liquidation
- Special exemption of remedies for religious corporations if
  - The corporation is a religious corporation
  - The act or omission, conduct or exercise of powers is based on a tenet of faith held by the members of the corporation; and
  - It was reasonable to base the decision on a tenet of faith, having regard to the activities of the corporation



- Must respect these rights, cannot contract out
- Not just affect corporations with broad based membership, rights also apply to closed membership corporations
- Having a smaller membership may reduce the exposure to these rights

## F. BOARD ISSUES

### 1. Election and Appointment of Directors

- Directors are elected by ordinary resolution of the members at AGMs
- Directors are not required to be members
- Exceptions
  - Vacancy in office of director - remaining directors may fill the vacancy as long as there is a quorum
  - Articles may permit directors to appoint additional directors between annual meetings

## 2. Directors Elected by Different Groups of Members

- Members in the same class have the same rights
- If different groups of members elect x directors to the board, must structure membership as separate classes
- For example
  - Directors elected by different regional representation of membership
  - Directors elected by different sector representation of membership
  - Directors elected by founding members
- Examples of possible workarounds
  - Qualification requirement for candidates
  - Candidate nomination process
  - Appointment of directors
  - Ex officio members and closed membership

### 3. Appointment of Directors

- Articles may permit directors to appoint directors between AGMs
- Number of appointed directors cannot exceed 1/3 the number elected at the last AGM (not 1/3 of the entire board)
- Need to take into account of rotating term – reduces the number of directors elected at each AGM
- Number appointed is within the max/min or fixed size of the board in the articles
- Appointed directors only hold one year term until next AGM
- Useful tool to get around prohibition of ex officio director or avoid having multiple membership classes

## 4. No Ex Officio Directors

- CNCA does not permit having ex officio directors
- Common for operating charities to have a representative sit on the board of its parallel foundation
- Examples
  - Representation from related charity
  - Past president

- Examples of possible workarounds
  - Establish the appointing body/person to be a separate membership class to elect a director - but will have multiple class vote issues
  - Have provision in articles to allow the board to appoint a director - by-law or policy can provide who would qualify to be appointed - but subject to an act of the board
  - Establish qualification requirements for candidate - but subject to election by the membership

## 5. Directors Ceasing to Hold Office / Removal

- Director ceases to hold office when the director dies, resigns, is removed in accordance with section 130 or becomes disqualified under section 126
- Section 126 provides that the following persons are disqualified - under 18 years old, declared incapable by a court in Canada or in another country, a person who is not an individual (such as a corporation), and a person who is bankrupt
- If the by-law requires a director to be a member, then the person would also be disqualified if he/she is no longer a member

- Directors can be removed by majority vote of members (or by class vote if elected by a particular class)
  - Cannot be subject to higher vote (e.g., 2/3 vote)
  - Cannot be removed by the board
- Not clear whether possible for a director to cease to hold office for other reasons without being removed by the members
  - Objective criteria - e.g., failing to attend 3 consecutive meetings
  - Subjective criteria - e.g., conduct bring disrepute to the corporation



## G. OFFICER ISSUES

### 1. Soliciting Corporations – Small Boards

- Soliciting corporations must have at least 3 directors, at least 2 directors must not be officers or employees of the corporation or its affiliates
- Prohibition of employees - No material effect on registered charities due to prohibition on directors receiving remuneration at common law
- Prohibition of officers - problem for small boards - e.g., board of 3 directors to hold chair, secretary and treasurer positions
- Examples of possible workarounds
  - 1 directors holds all officer positions, leaving 2 at large directors
  - Expand size of the board
  - Appoint non-directors to be officers

## 2. Officers to Sit on the Board Ex Officio

- Members elect officers who sit on the board ex officio
- But CNCA does not permit ex officio directors
- Example of possible workarounds
  - Members elect directors to certain seats on the board who are required to fill certain officer functions - become officers ex officio

## H. BY-LAW ISSUES

### 1. By-law Amendment Mechanism

- CNCA provides two ways for corporations to amend their by-laws, depending on the subject matter of the changes
- Default mechanism
  - Board may adopt by-laws, effective upon passage by the board
  - Must be confirmed by members at next meeting to remain in force
- Special approval
  - For matters affecting members' rights, e.g., notice of members' meetings, membership transferability and conditions, absentee voting
  - Effective when confirmed by members by special resolution (no need for board approval)

- By-laws drafted under the CNCA must be very clear about which amending formula applies to various provisions (or risk certain by-law provisions not being legally in force) – for example
  - Have 2 by-laws with all by-law provisions requiring special resolution in a separate by-law
  - Have 1 by-law, and place all provisions requiring special resolution in one clearly marked section
  - Have 1 by-law, and clearly mark throughout by-law which provisions require special resolution to amend
  - Have 1 by-law, and provide in articles that all by-law amendments require a special resolution

## 2. Approaches to By-law Drafting

- By-laws will need to be replaced or substantially revised because the old and new rules are very different
- Minimalist approach by-laws
  - Rationale: CNCA contains detailed rules, so by-laws not to duplicate mandatory rules or default rules that are not to be overridden
- Comprehensive approach by-laws
  - One stop approach - consolidation of all applicable rules
  - No need to flip back and forth between articles, but limited provisions in the articles
  - Can have governance policy manuals to address other matters, e.g., committee structures (but not audit committee)

- Two mandatory provisions that must be included in by-laws
  - Conditions of membership
  - Notice of meeting of members
    - By-laws must set out the manner in which notice of meeting of members is to be given as prescribed in the regulations
    - Four options are prescribed in the regulations
    - May choose one or more of the options
  - May include these provisions in the articles instead

### **3. Rules on Public Accountant and Financial Review**

- CNCA divides corporations into two categories for purpose of determining obligation to appoint a public accountant and level of financial review
- Designated corporations
  - A soliciting corporation with gross annual revenues for its last completed financial year that are equal to or less than \$50,000 or that is deemed to have such revenues under the Act
  - A non-soliciting corporation with gross annual revenues for its last completed financial year that are equal to or less than \$1 million
- Non-designated corporations are soliciting and non-soliciting corporations with annual revenues in excess of these amounts

Type of Corporation (Gross Annual Revenues)			Appointment of Public Accountant (PA)	Review Engagement or Audit
Soliciting	Designated	\$50,000 or less	Members must appoint a PA by ordinary resolution at each annual meeting. Exception – Members may waive appointment by annual unanimous resolution	PA must conduct review engagement, but members may pass an ordinary resolution to require an audit instead. (If no PA is appointed, then compilation only)
	Non-Designated	More than \$50,000 and up to \$250,000	Members must appoint a PA by ordinary resolution at each annual meeting	PA must conduct an audit, but members can pass a special resolution to require a review engagement instead
	Non-Designated	more than \$250,000	Members must appoint a PA by ordinary resolution at each annual meeting	PA must conduct an audit.



<b>Type of Corporation (Gross Annual Revenues)</b>			<b>Appointment of Public Accountant (PA)</b>	<b>Review Engagement or Audit</b>
Non-Soliciting	Designated	\$1 million or less	Members must appoint a PA by ordinary resolution at each annual meeting. Exception – Members may waive appointment by annual unanimous resolution	PA must conduct review engagement, but members may pass an ordinary resolution to require an audit instead. (If no PA is appointed, then compilation only)
	Non-Designated	more than \$1 million	Members must appoint a PA by ordinary resolution at each annual meeting	PA must conduct an audit.

- How much detail to include in the by-law
  - Include applicable detailed rules
    - Soliciting corporation - include rules for soliciting corporations
    - Non-soliciting corporation - include rules for non-soliciting corporations
  - Corporations that may flip in and out of soliciting status
    - Include both sets of rules
    - By-law to simply states that the corporation will comply with the rules, set out the rules in policy
  - Corporations that want to have an audit in any event - by-law can simply state that the financials will be audited, subject to the Act

## I. CONFLICT OF LAWS – FOR CHARITIES

- CNCA must be read in conjunction with applicable charity law
- Some provisions of the CNCA will not apply to charities
- CNCA permits directors to fix their remuneration and to receive reasonable remuneration and expenses for any services they provide to the corporation in any other capacity
  - Common law rule overrides the CNCA - prohibits directors of a charity to receive direct and indirect remuneration from the charity
  - But directors may be reimbursed out-of-pocket expenses
  - Possible to seek PGT consent court order to permit directors be paid, but generally high threshold

- CNCA permits directors and officers to enter into contracts or transactions with the corporation as long as they disclose any conflict of interest that may exist
  - Common law rule overrides the CNCA - prohibits directors of charities from placing their personal interests in conflict with their duty to the charity
  - Regardless of whether there is actual loss to the charity
  - Possible to seek PGT consent court order to permit directors be paid, but generally high threshold for such an order

- CNCA permits a corporation to invest its funds as its directors think fit, subject to its articles or by-laws or any limitations accompanying a gift
  - Section 10.1 of the *Charities Accounting Act* overrides the CNCA - states that s.27 to s.31 of the *Trustees Act* applies
  - Prudent investor rule applies to the directors of charities
  - Directors must consider certain criteria to invest
  - Authorizes delegation to an agent in certain circumstances

- CNCA permits corporation to indemnify the directors and officers and to purchase insurance
  - For charities in Ontario, this is subject to compliance with the *Charities Accounting Act* and its regulations
  - Regulation 4/01 under the *Charities Accounting Act* requires directors to consider certain factors enumerated in the regulation before they consent to the indemnification of its directors or purchasing D&O insurance
  - The indemnification or the purchase of insurance must not render the corporation insolvent

## J. PRACTICAL STEPS FOR CONTINUANCE

1. Gather current governance structure and procedure
2. Review governing documents and consider
3. Review the key features of the CNCA
4. Compare CNCA rules with current governance structure and practice
5. Determine whether changes should be made prior to continuance
6. Timing of continuance
7. Drafting articles and drafting by-laws
8. Obtain membership approval and filing
9. Other consequential filings and records updates

## CONCLUSION

- Application of some of the rules is not clear
- Some corporations may need to consider workarounds in order to comply with the CNCA while maintaining its desired governance structure
- Corporations Canada has continuance tools available, e.g., model by-laws, continuance guide, guide on operating under the CNCA after continuance ([http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h\\_cs03925.html](http://strategis.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h_cs03925.html))
- See CRA requirements (<http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/nfpc/menu-eng.html>)
- Do not miss the 3 year time frame for continuance
- Meet the October 17, 2014 deadline!



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TOLL FREE: 1-877-942-0001

Ottawa Toronto Mississauga Orangeville  
[www.carters.ca](http://www.carters.ca) [www.charitylaw.ca](http://www.charitylaw.ca) [www.antiterrorismlaw.ca](http://www.antiterrorismlaw.ca)