

# Community Dispatch

An InfoFax of Community Development Halton

May 2008

Vol. 12, No. 4

## Revising the Ontario *Corporations Act*: Part 1 of 3 – Incorporation

*In May 2007, the Ontario Ministry of Government and Consumer Services embarked on a project to review and modernize the Ontario Corporations Act, the legislation that governs the creation, governance, and dissolution of Ontario not-for-profit corporations. The Ministry has released three consultation papers to solicit comment and suggestions regarding reform of this important legislation. Each focuses on certain aspects of the Corporations Act (see table, p.6).*

*The Ontario Nonprofit Network (ONN), a coalition of individuals and nonprofit organizations in the arts, social services, community health, social planning, environment and other areas, has established an Expert Working Group to address reform of the Corporations Act. Comprising individuals from the nonprofit sector in partnership with experts in nonprofit law, the ONN Expert Working Group has released a briefing paper to our sector on each of the consultation papers. Among its recommendations is that **new, separate legislation is required to recognize and address the unique qualities, functions and purposes of Ontario's public benefit sector**, distinct from legislation governing other forms of non-profits (ONN 2008c, 3).*

*This series of three Community Dispatches provides a brief synopsis of the issues outlined in the Ministry's consultation papers and the recommendations of the ONN Expert Working Group. Part 1 covers the issues related to Consultation Paper #1. Parts 2 and 3 cover the issues dealt with in Consultation Papers 2 and 3 and the corresponding briefing papers of the ONN Expert Working Group. Comprehensive discussion on these issues is contained in the Ministry's Consultation Papers, and the ONN's full briefing papers.*

*We encourage all nonprofits to engage in this process and to submit their own comments to the Ministry of Government and Consumer Services. **The deadline for submissions is May 31, 2008.** The ONN briefing papers contain directions for submitting your response to the Ministry. The full Ministry consultation papers, ONN briefs, as well as submissions by Imagine Canada and the United Ways of Ontario Council are found at <http://ontariononprofitnetwork.ca/resources/all> Additional explanation and discussion are found in the Ministry's Supplementary Materials at [www.gov.on.ca/mgs/en/AbtMin/STEL02\\_047145.html](http://www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html)*

*Joey Edwardh, Executive Director*

### **The Need for Separate Legislation for Public Benefit Corporations**

The ONN states:

*“Public benefit corporations are different from other nonprofit groups, such as associations, unions and clubs, which tend to exist to serve their members...a public benefit corporation can be identified and differentiated from other nonprofits by its commitment to devote its assets solely for public benefit” (ONN 2008c, 3).*

The ONN Expert Working Group

**“...is of the strong opinion that new, separate legislation is required to recognize and address the unique qualities, functions and purposes of Ontario's public benefit sector. The legislation should be titled, “Public Benefit Corporations Act” (ONN 2008c, 3).**

We encourage nonprofit organizations to add their voice on this issue (see letter that accompanies this *Community Dispatch*).

## Background

The *Corporations Act* came into being in 1907 as the *Companies Act*. Until 1971, the *Act* governed both not-for-profit and for-profit business corporations (the latter are now governed by the *Ontario Business Corporations Act*). Since the last substantial revision of the *Corporations Act* in 1953, the governance, economic impact and service delivery of nonprofits in Ontario have changed dramatically.

The goal of reform is to address legislative gaps, enable activity by a diversity of not-for-profit corporations, and provide more flexible and up-to-date rules for dealing with the relationship between a corporation and its directors, officers, and members; improved corporate governance and accountability; streamlining of incorporation and efficient operation of not-for-profit corporations. It also seeks to eliminate provisions that are no longer relevant (such as those areas now governed by the *Ontario Business Corporations Act*). The consultation recognizes that Ontario's nonprofit organizations are very diverse, addressing a wide range of needs, from social services for all age groups to programs in sports, recreation and the arts, and include both non-charitable (such as social clubs, athletic organizations and trade associations) and charitable organizations.

## General Recommendations of the Ontario Nonprofit Network (ONN)

1. That the revised *Act* should focus exclusively on not-for-profit incorporation, and not attempt any charitable regulation, which is already undertaken in other legislation.
2. That, in addition to modernization of the *Corporations Act*, reform of existing charitable *regulation* and oversight is urgently required
3. That a dedicated Not-for-Profit (NFP) *Corporations Act* is needed and that "true membership *corporations*" (organizations that can *distribute* assets to members upon dissolution) should be dealt with in other legislation. In its brief on *Consultation Paper #3* the ONN makes this last point more firmly,

recommending new, specific legislation for public benefit corporations.

## ISSUE: The Incorporation Process: Letters Patent or "As of Right"?

Currently, not-for-profit corporations are incorporated by applying for "letters patent" under the *Corporations Act*, after which Ministry staff review the application and determine whether incorporation as a not-for-profit organization will be permitted. In other words, incorporation is at the discretion of the Ministry although, in practice, it is normally granted "if in accordance with the Ministry's policies made under the authority of the statute" (MGCS 2007c, 2). In the case of organizations applying as *charitable* not-for-profit organizations, Ministry policy also requires the prior consent of the Office of the Public Guardian and Trustee.

The Ministry states that "since the main aim of organizational law is to facilitate not-for-profit activity, unnecessary barriers restricting access [to incorporation] by not-for-profit organizations should be minimized." It notes that, in contrast to Ontario's current system, in which permission to incorporate is at the Ministry's discretion, many jurisdictions now permit not-for-profit organizations to incorporate *as of right*; and that, for businesses, all statutes in Canada (including Ontario's *Business Corporations Act*) allow incorporation *as of right*. This means that the incorporation may take place at the time of filing and submitting required fees, and that "if certain legal requirements are satisfied, the Ministry would not be able to decline to issue a certificate of incorporation but will only be able to insist on receiving those documents and fees prescribed by law" (MGS 2007a, 7).

*Consultation Paper #1* states that incorporation *as of right* "would limit the scope of the Ministry's review and could expedite the incorporation process." However, it also notes that concerns have been raised that, without Ministry review and approval, errors and ambiguities (including the possibility that unqualified organizations might erroneously describe themselves as a "charity") might go unnoticed, creating a "need to rectify

errors after incorporation and even the possibility that invalid corporations could be operating in the province” (MGS 2007a, 7).

**ONN Recommendation:** The Ontario Nonprofit Network supports as of right legislation, similar to that in for-profit legislation and to Saskatchewan’s not-for-profit legislation (ONN, 3).

### **ISSUE: Structure of the New Act**

This pertains to making a revised *Act* easier to navigate. For details see MGS 2007a, 9 and Supplementary Materials (MGCS 2007c, 6).

### **ISSUE: Definition and Purposes of a Not-for-profit Corporation**

The definition of a not-for-profit corporation includes two components: *not-for-profit purpose* (that the purpose is not one of profit or pecuniary advantage of members) and *non-distribution constraint* (that a not-for-profit corporation does not distribute its property to its members except after dissolution, and then only for certain types of organizations).

*Consultation Paper #1* suggests that, “as the scope of activity engaged in by not-for-profit corporations becomes increasingly broad, it might be desirable to clearly define the permitted purposes and activities” (MGS 2007a, 10). Prior to 1994, the *Corporations Act* included a list of permitted objects for not-for-profit corporations; in 1994 this was expanded to permit the inclusion of certain organizations that did not fall within those parameters. More discussion is contained in the *Supplementary Materials* (MGCS 2007c, 9).

The *Corporations Act* states that a not-for-profit corporation “shall be carried on without the purpose of gain for its members” but is not specific as to what is prohibited by this. Directors and officers are allowed to receive reasonable remuneration and expenses for services, and the provision is generally interpreted as prohibiting only direct distribution of profits to members, and to preclude profit-making activities except where they are incidental to the principal purposes of the organization. However, there are some areas that

could be considered for clarification as, for example, trade associations, which are currently permitted to incorporate as not-for-profit corporations, even though they may “indirectly advance the pecuniary interest of their members by advancing a common interest” (MGS 2007a, 10). Some models in other jurisdictions provide for multiple classes of corporations, to allow for these distinctions. More discussion is contained in the *Supplementary Materials* (MGCS 2007c, 7-9).

**ONN Recommendation:** The ONN recommends that “there should be no defined purposes for NFP [not-for-profit] corporations beyond operating for public benefit purposes,” noting that “classifications and definitions of allowable purposes for public benefit organizations invariably fail to capture the full scope and diversity of the activities undertaken by the sector. Moreover, the sector is known for its creativity and responsiveness to changing communities” (ONN 2008a, 4).

### **ISSUE: Activities of Not-for-Profit Corporations**

Not-for-profit corporations may undertake for-profit activities as a source of revenue (museum gift shops, hospital parking lots and product sales and endorsements are cited as examples). The *Corporations Act* is not explicit on whether such activities may be engaged in, although it has “generally been applied to mean that a not-for-profit corporation may engage in activities that produce a profit, provided that those activities are incidental to the principal objects of the corporation and in furtherance of them” (MGS 2007a, 12).<sup>1</sup>

In considering whether legislative change is required with respect to these activities, among the issues being considered is that of “unfair competition” with for-profit businesses. Some other jurisdictions have dealt with these issues by specifying constraints on the purpose or scale of commercial activity or mandating that not-for-profit corporations engaged in commercial activity do so through a subsidiary.

<sup>1</sup> For some organization, other statutes, such as the *Income Tax Act* and *Charitable Gifts Act* also provide regulation on this matter.

**ONN Recommendation:** The ONN recommends that “the new act should not regulate or restrict the capacity of NFP [not-for-profit] corporations to earn revenues,” arguing that such revenues are directed toward meeting their public benefit objectives (ONN 2008a, 3).

### **ISSUE: Non-Distribution Constraint**

Under the *Corporations Act*, a corporation may pass by-laws stipulating that, if it is dissolved, its property shall be distributed to government, municipal corporations, charitable organizations or other organizations beneficial to the community. In the absence of such by-laws, property is to be distributed equally among members. However, in the case of charitable organizations, such distribution is prohibited under other legislation. The question being posed in the consultations is whether the *Corporations Act* needs to provide more clarity on this matter and which model of non-distribution constraint should be adopted. More discussion is contained in the *Supplementary Materials* (MGCS 2007c, 11-13).

**ONN Recommendation:** The ONN recommends “NFP [not-for-profit] legislation should have robust distribution constraints preventing excessive compensation to staff, directors and members with exceptions for indemnification, expenses and remuneration of a director or member for services. Upon dissolution, the assets of the NFP corporation would be gifted to another like organization or as set out by its by-laws, keeping the assets in the public domain” (ONN 2008a, 4).

### **ISSUE: Classification System**

Not-for-profit corporations range from member-owned tennis clubs to charitable organizations that provide social services. Currently, there is only one class of not-for-profit corporation under the *Corporations Act*. It has been suggested that reforming the *Act* to allow multiple classes of not-for-profit corporations would better meet the needs of the wide range of not-for-profit corporations in Ontario. However, there are also concerns that confusion may result, that some organizations may be wrongly classified and that some organizations that combine public benefit

and member benefit purposes (examples cited are service clubs and religious or ethnic organizations) may prove difficult to classify.

Some models for classifying not-for-profit organizations are based variously on whether they are charitable vs. membership organizations; whether distribution to members is allowed; whether they are soliciting or non-soliciting organizations; or distinguishes organizations by whether they are religious, charities, political, for mutual benefit or general not-for-profit. More discussion is contained in the *Supplementary Materials* (MGCS 2007c, 14).

**ONN Recommendation:** The ONN states that “classifications and definitions of allowable purposes for public benefit organizations invariably fail to capture the full scope and diversity of the activities undertaken by the sector” (ONN 2008a, 4).

### **ISSUE: Corporate Powers and Capacity**

The *Corporations Act* allows not-for-profit corporations to act as “natural persons,” that is, to behave as an individual would in activities such as entering into contracts. It also grants specific powers to conduct activities such as passing by-laws, constructing and maintaining buildings, purchasing or leasing land, and so on.

However, the legal doctrine of *ultra vires* places some restrictions on the actions of corporations, declaring that if a corporation over-reaches what it is entitled to do, those actions are considered void. The intention of the doctrine is to protect investors and creditors of a corporation by placing some limitations on the corporation’s activities; however, it has also had harmful effects on third parties where what the *Consultation Paper* terms “countless” contracts were declared void under the doctrine (MGS 2007a, 21).

The question being posed in the consultations on the *Corporations Act* is how to define a balance between the rights and the limitations on powers of not-for-profit corporations. More discussion is contained in the *Supplementary Materials* (MGCS 2007c, 15-16).

**ONN Recommendation:** The ONN recommends, “except to the extent otherwise provided in its articles, a [not-for-profit] corporation should have the corporate power and capacity of a natural person” (ONN 2008a, 3).

*Director and Officer Liability are covered in Part 2. Financial Disclosure and Members’ remedies are covered in Part 3.*

## References

Ministry of Government Services (MGS, 2007a). *Consultation paper: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto]: May 7, 2007. [www.gov.on.ca/mgs/en/AbtMin/STEL02\\_047145.html](http://www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html)

Ministry of Government Services (MGS, 2007b). *Consultation paper #2: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto]: August 22, 2007. [www.gov.on.ca/mgs/en/AbtMin/STEL02\\_047145.html](http://www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html)

Ministry of Government and Consumer Services (MGCS, 2007c). *Supplementary materials to May 7, 2007 consultation paper: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto: Dec 2007]. [www.gov.on.ca/mgs/en/AbtMin/STEL02\\_047145.html](http://www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html)

Ministry of Government and Consumer Services (MGCS, 2008). *Consultation paper #3: Modernization of the legal framework governing Ontario not-for-profit corporations*. [Toronto: February 28, 2008]. [www.gov.on.ca/mgs/en/AbtMin/STEL02\\_047145.html](http://www.gov.on.ca/mgs/en/AbtMin/STEL02_047145.html)

Ontario Nonprofit Network Expert Working Group (ONN, 2008a). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #1*. <http://ontariononprofitnetwork.ca/resources/all>

Ontario Nonprofit Network Expert Working Group (ONN, 2008b). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #2*. <http://ontariononprofitnetwork.ca/resources/all>

Ontario Nonprofit Network Expert Working Group (ONN, 2008c). *Revising the Corporations Act: A brief to the sector from the Ontario Nonprofit Network Expert Working Group regarding Consultation Paper #3*. <http://ontariononprofitnetwork.ca/resources/all>

<ul style="list-style-type: none"> <li>• <b>Consultation Paper #1</b> (May 7, 2007)</li> </ul>	<p align="center"><b>Consultation Paper #2</b> (August 22, 2007)</p>	<p align="center"><b>Consultation Paper #3</b> (February 28, 2008)</p>
<ul style="list-style-type: none"> <li>• 1. Incorporation "as of right"?</li> <li>• 2. Structure of the new Act</li> <li>• 3. Definition of a nonprofit corporation               <ul style="list-style-type: none"> <li>• 3.1 Not-for-Profit Purpose</li> <li>• 3.2 Non-distribution Constraint</li> </ul> </li> <li>• 4. Classification system</li> <li>• 5. Corporate powers and capacities</li> <li>• 6. Other issues (in brief):               <ul style="list-style-type: none"> <li>• 6.1 Director and officer liability</li> <li>• 6.2 Financial Disclosure</li> <li>• 6.3 Members' Remedies</li> </ul> </li> </ul>	<ol style="list-style-type: none"> <li>1. Board structure           <ol style="list-style-type: none"> <li>1.1 Number of Directors</li> <li>1.2 Qualification of Directors</li> </ol> </li> <li>2. Term of office</li> <li>3. Directors' meetings           <ol style="list-style-type: none"> <li>3.1 Notice</li> <li>3.2 Resolution in lieu of Meeting</li> </ol> </li> <li>4. Resignation and removal of directors</li> <li>5. Officers</li> <li>6. Directors' and officers' liability           <ol style="list-style-type: none"> <li>6.1 Duty of care and loyalty</li> <li>6.2 Due diligence defence</li> <li>6.3 Indemnification and insurance</li> <li>6.4 Immunity from liability</li> </ol> </li> <li>7. Conflict of Interest</li> </ol>	<p align="center"><b>MEMBERSHIP</b></p> <ol style="list-style-type: none"> <li>1. Membership lists</li> <li>2. Members' voting agreements</li> <li>3. Quorum</li> <li>4. Transferability of membership interest</li> <li>5. Termination and disciplinary matters</li> <li>6. Remedies           <ol style="list-style-type: none"> <li>(a) compliance order;</li> <li>(b) oppression;</li> <li>(c) derivative action;</li> <li>(d) dissent and appraisal.</li> </ol> </li> </ol> <p align="center"><b>CORPORATE FINANCE</b></p> <ol style="list-style-type: none"> <li>1. Financial review in lieu of an audit</li> <li>2. Financial disclosure</li> <li>3. Borrowing and debt issuance</li> </ol> <p align="center"><b>OTHER</b></p> <ol style="list-style-type: none"> <li>1. Standard by-laws</li> <li>2. Self-perpetuating board</li> </ol>



Produced by Community Development Halton  
 860 Harrington Court  
 Burlington, Ontario L7N 3N4  
 (905) 632-1975, (905) 878-0955; Fax: (905) 632-0778;  
 E-mail: [office@cdhalton.ca](mailto:office@cdhalton.ca)  
 Web site: [www.cdhalton.ca](http://www.cdhalton.ca)  
[www.volunteerhalton.ca](http://www.volunteerhalton.ca)

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