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CHARITIES & NOT-FOR-PROFIT NEWSLETTER

March 2005

The Charities and Not-for-Profit Newsletter is published periodically in French and English by Miller Thomson LLP's Charities & Not-for-Profit Group as a service to our clients and the broader voluntary sector. We encourage you to forward the e-mail delivering this newsletter to anyone (internal or external to your organization) who might be interested. Complimentary e-mail subscriptions are available by contacting charitieseditor@millerthomson.ca.

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SEMINARS

Toronto

Miller Thomson, Deloitte & Touche and RBC Royal Bank will be presenting a breakfast seminar entitled "Fraud and the Non-Profit Organization" at the Fairmont Royal York Hotel in Toronto on April 7 from 7 a.m.-10 a.m. Those wishing to attend this seminar should contact Maria Medeiros at 416.643.8005.

Waterloo-Wellington

The Guelph Volunteer Centre salutes Volunteer Week with Miller Thomson and Deloitte & Touche by presenting a full-day seminar at The Cutten Club in Guelph on April 21. The Guelph seminar will include presentations on Intellectual Property, Cross-border Tax Law Issues for Charities, Duties and Responsibilities of Directors and Officers, Recent Tax Changes for Charities, and Fraud Prevention, as well as a presentation by Arthur Drache.

Those wishing to attend this seminar should contact The Guelph Volunteer Centre at 1.866.693.3318.

IN INVESTMENTS, PRUDENCE DOES NOT NECESSARILY EQUATE WITH CONSERVATISM

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One issue that arises continually when advising charities is the need for charities to implement prudent investing policies. It goes without saying that trustees and directors of charities that have funds to invest must be prudent. But we continue to find that in an extraordinary number of cases, prudence is equated with "conservatism" and trustees tend to take no risk whatever. They seem to think that if they invest only in government bonds or their equivalent, they are acting prudently.

This approach might have been acceptable a decade or two ago, when such investments could easily produce double digit returns at minimal risk. Even then, this approach ignored the erosion of the capital in real dollar terms because of inflation. The "no-risk" approach has not necessarily been a prudent one in the last decade. Where returns on debt investment rarely exceeded 2-4%, and the disbursement quota for foundations was 4.5%, investing solely in debt instruments has been disastrous.

Many provincial acts regulating trustees have been revised and amended in a manner that suggests the issues which must be taken into account by trustees generally. For example, in Alberta, the plain English explanation of the prudent trustee rule states:

> … the prudent investor approach expressly instructs the trustee to consider certain matters when planning the investment of trust funds, including:
>
> - the purposes and probable duration of the trust, the total value of the trust's assets and the needs and circumstances of the beneficiaries;
> - the need to maintain the real value of the capital or income of the trust;
> - the need to maintain an appropriate balance between risk, expected total return from income and the appreciation of capital, liquidity and regularity of income;
> - the importance of appropriate diversification of investments;
> - the role of different investments or courses of action in the trust portfolio;
> - the expected tax consequences of investment decisions or strategies.

Other provinces, including Ontario and British Columbia, have similar guidelines.

Some of the tax problems that arise as a result of low investment returns have been addressed in the newly-revised disbursement quota rules which are now before Parliament. But interestingly enough, the "solution" will not help those charities that remain fully invested in debt instruments.

The big legislative change is that the disbursement quota has been reduced to 3.5% of the capital of a foundation (and this approach will, by 2009 at the latest, apply to all charitable organizations). That is a welcome change, but for the most part, given today's interest rates, a charity fully invested in debt will be hard pressed to produce even 3.5% plus the overhead costs of operations that are required by the disbursement quota.

The new legislation also gives some breaks to charities that are holding gifts subject to the so-called "ten year" rule. If the donative document allows for it, the charity can dip into the "capital gains pool" to spend realized capital gains to meet any disbursement quota shortfall. But the key here is that in order to take advantage of this relieving provision, there have to be realized capital gains … and a charity that holds a portfolio made up primarily of debt assets or money-market funds will be unlikely to generate any capital gains.

If the charity has capital that is not subject to the ten-year restrictions (such as funds received from bequests, life insurance death benefits, profits from related business and so forth), then the only way a shortfall can be met will be by dipping into capital, which is never an attractive proposition at any time for trustees of charities.

We point out, in passing, that the notion of ten-year gifts (that is, gifts subject to the provision that the capital and property substituted therefor cannot be used for a minimum of ten years) was considered to be a relieving provision when originally introduced in 1975-76. Prior to that time, special treatment was only given to gifts made subject to the requirement that the property be held in perpetuity. A charity that wants to utilize pre-1976 capital should check with its lawyers as to whether the terms of the gift allow any encroachment at all; much will depend on the wording of the original donation document. There have been several court cases in the past few years where the trustees have had to go to court to get permission to vary the terms of gifts made in the 1920s and 1930s because, without such permission the terms of the gift could not be changed to meet disbursement quota rules, rules that.were non-existent when the gifts were made.

The fact of the matter is that trustees who want to meet their statutory or common law obligations to invest as prudent investors would almost always have to have a significant equity component in their portfolio. They cannot hide behind some self-developed notion of what is prudent based on what they learned twenty, thirty or forty years ago.

Obviously, if the charity has only modest capital, diversifying becomes difficult if not impossible. But certainly once the capital is into six figures, the issue must be addressed. And as the size of the capital increases, the need for diversification becomes even more important as an element of prudent investing. This sort of

diversification does not mean you have to consider hedge funds, currency swaps or even income trusts as investments (though some very large charities use all of these investment vehicles for at least a portion of their portfolios), but prudent trustees cannot ignore the importance of solid equity investments with a good track record.

Unless interest rates in Canada rise considerably, this issue will not go away.

APPLICATION OF HUMAN RIGHTS LAW TO CHARITIES

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All Canadian jurisdictions now have human rights legislation at the federal and provincial (or territorial) levels. The scope and objectives of the legislation governing human rights are similar, although each jurisdiction's statute must be examined closely to show the specific requirements of the governing legal framework.

There is now a well-established body of law in Canada on the human rights issues. The jurisprudence is found both in decisions of human rights tribunals, and in court decisions that interpret the governing statutes. The Supreme Court of Canada also has a significant body of case law in this area.

Most human rights legislation contains a "purposes" clause that sets out the goals of the legislation. For example, in British Columbia, the purposes of the *Human Rights Code* include: fostering a society in which there are no impediments to full and free participation in the economic, social, political and cultural life of British Columbia; promoting a climate of understanding and mutual respect where all are equal in dignity and rights; preventing discrimination; and providing a means of redress for persons who are targets of discrimination.

The *Canadian Human Rights Act* provides that its purpose is to extend the laws of Canada on the principle that all individuals should have an opportunity equal with others to make for themselves the lives that they are able and wish to have. Further, all individuals should have their needs accommodated consistent with their duties and obligations as members of society without being hindered or prevented from doing so by discriminatory practices based on race, national or ethnic origin, colour, religion, age, sex, sexual orientation, marital status, family status, disability or conviction for an offence for which a pardon has been granted.

In Ontario, the preamble to the provincial *Human Rights Code* recognizes the dignity and worth of every person and states that it is the policy of Ontario to provide equal rights and opportunities without discrimination that is contrary to law. The aim of the Ontario *Human Rights Code* is to create a climate of understanding and mutual respect for the dignity and worth of each person, so that each person feels a part of the community and is able to contribute fully to the development and well-being of the community and the Province.

The purposes articulated in the legislation are important because they provide a framework against which the legislation is interpreted. Our courts have held that human rights legislation is to be interpreted purposefully and broadly. The Supreme Court of Canada has stated that human rights legislation is special, being quasi-constitutional in nature.

Prohibited Grounds of Discrimination

All of the human rights acts in Canada set out prohibited grounds of discrimination. The legislation is based on the concept that a person who is a member of a defined group should not be subjected to differential treatment. The process is typically complaint-driven, being responsive to complaints of individuals about alleged discriminatory treatment.

Motive or intent is generally not an issue for human rights tribunals. Instead, the tribunal will be concerned whether certain conduct has a prohibited discriminatory effect on an individual. In this way, the law is intended to be remedial, not punitive.

Where a party violates in any way a prohibited ground of discrimination, the usual result is a finding that the relevant human rights legislation was breached. For example, an employee may be disciplined or terminated for failing to meet an employer's reasonable performance standards. If one of the reasons for the termination, however, was because of excess absenteeism due to illness (and no attempt was made to accommodate this problem), there may well be a finding that the employer discriminated against the employee on the ground of physical disability.

The grounds of discrimination are generally found in the relevant legislation, and most Canadian legislation has similar prohibitions. Typically, human rights legislation prohibits discrimination on the basis of gender, family status, social condition (though not found in all legislation), criminal record, sexual orientation, etc. As well, most jurisdictions prohibit discrimination with respect to employment, including employment advertisements. Most also prohibit discrimination in the provision of accommodation, services, and facilities. Some but not all jurisdictions deal with the notion of workplace harassment. For example, in Ontario, occupants of a building have a right to freedom from harassment from a landlord or by an occupant in the same building due to race, ancestry, place or origin, marital status, etc.

There are exceptions for certain types of religious and other organizations that are designed to permit these organizations to employ only those that accept the organization's religious or other principles and practices. However, since these exceptions may not apply in all circumstances, religious organizations should not rely on them without seeking specific legal advice.

Investigation and Enforcement

Most jurisdictions in Canada have a human rights commission that serves both an educational and investigative role. A commission receives and investigates complaints. In this role, it may dismiss a complaint as being without merit. Where a commission decides that there is a substantive issue to be determined, it typically refers the complaint to a board of inquiry or to a human rights tribunal for adjudication. The commission in British Columbia, however, was dissolved recently, and the B.C. Human Rights Tribunal now deals with all related matters.

A board of inquiry or human rights tribunal will conduct a quasi-judicial hearing into the dispute. Mediation may or may not be available to the parties prior to the hearing. Typically, a hearing will be conducted, and the parties will be entitled to be present with counsel to present their respective positions.

In some jurisdictions there is a right to appeal the decision of a human rights adjudicator to the courts. For example, in Ontario, any party to a proceeding may appeal from a decision or order of the human rights tribunal to the Divisional Court. Other jurisdictions rely on the normal procedural rules that govern judicial review of administrative action.

The remedies available to most tribunals include issuing orders for damages and costs. Reinstatement to employment may be ordered as well in appropriate cases.

Employers may be liable for the conduct of their employees under the principle of vicarious liability. The Supreme Court of Canada has recognized that this principle applies to human rights law.

In addition to remedies set out in the legislation, complainants may have alternative remedies available. Where a collective agreement governs an employment relationship, there may be an option of arbitration for redress of human rights issues which are related to that employment. In appropriate cases, there may also be other remedies available. There have, for example, been cases where human rights remedies have been pursued under workers' compensation legislation.

Conclusion

Canadian human rights legislation is now an established part of the fabric of Canadian law. It applies to all "persons" in Canada, including charities and not-for-profit organizations. All have a legal responsibility to treat the individuals with whom they deal equally and to avoid improper discrimination.

In the employment field, charities and not-for-profit organizations that act as employers must be particularly careful. Their employees and the clients they serve must not be subjected to improper differential treatment. As well, in appropriate circumstances, disabilities and other conditions must be accommodated.

If you are faced with a questionable situation, please consult counsel before taking action. While the human rights legislation in Canada is intended to be remedial and not punitive, it is nevertheless an unpleasant and costly experience to be subjected to a human rights complaint. There are lawyers in each of our offices who can advise you on human rights issues that may arise in your jurisdiction.

NON-COMPETITION CLAUSE ENFORCED AGAINST FORMER EMPLOYEE*

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Many charitable and not-for-profit organizations are concerned that their employees might go to the competition and help their new employer pursue opportunities that would otherwise have come to them. For example, fundraisers might convince their regular donors to follow them to the new organization, to the detriment of their former employer. Some employers seek to rely upon alleged fiduciary duties to control this type of behaviour, while others have their employees enter into non-solicitation, or non-competition covenants.

Would you expect the courts to enforce a non-competition clause that prevented the individual from competing anywhere in the world for a period of five years? If you have been keeping up with your reading on such topics, the answer is probably "no." The trend in recent years has been not to enforce such clauses where other, less restrictive, means (such as non-solicitation clauses) would be sufficient, or where the terms of the non-competition clause in question are particularly onerous. However, a court recently upheld a five year, global restriction competition, despite finding that the company might be able to protect itself through other means.

In *Martinrea International Inc. v. Canadian Hydrogen Energy Co.*, the parties, a corporation and an individual, entered into a Non-Disclosure Agreement that included a non-competition clause. Although the decision does not review the underlying facts in detail, the Judge took note of the following:

- The company was not operating on a world-wide basis but had aspirations of expanding into international markets, and in fact, the individual in question had worked toward securing global protection for its patents;
- The company had only been operating for two years;
- The parties were both knowledgeable and had equal bargaining power when they entered into the agreement (in fact, the Court noted that if either of them had superior bargaining power, it was the individual);
- When he signed the agreement, the individual was of the opinion that non-competition clauses were difficult to enforce, but he chose to sign the agreement anyway; and
- At the conclusion of the relationship, the individual expressed a desire to begin competing with the company.

The Court acknowledged some of the previous decisions on this topic, focussing on how the factual context of each case is particularly important. The Court went on to find that the world-wide nature of the prohibition was reasonable in light of the company's international aspirations. Furthermore, the Court found that there was nothing unreasonable, in the circumstances, with a five year term.

It is notable that the Court explicitly commented that "the fact that the respondent might protect its legitimate interests through other means does not make this non-competition clause unreasonable. The non-competition

clause provides a more efficient, less convoluted means to protect the respondent's legitimate interests."

The Court did not discuss what the other means might be. Typically, the Courts have held that where a non-solicitation clause will protect a company's interests adequately, they will not enforce a non-competition clause. In this case, it is not clear whether a non-solicitation clause was a viable option or not.

The Court also did not provide any basis for finding that the five year term was not unreasonable, despite the fact that far shorter terms are usually allowed.

Finally, it is interesting to note that this case proceeded as an application, rather than a typical action culminating in a trial. Applications are usually used where there are few material facts in dispute, and the only question facing the Court is how the law should be applied to the essentially undisputed facts. In this case, the company sought to have a trial, as they submitted that there were a number of important factual disagreements. The Court chose to proceed by way of Application despite this opposition.

The decision was only rendered on January 10, 2005. It remains to be seen whether or not it will be appealed, and how it will be treated by other courts. Given the minimal facts that are contained in the decision, it is difficult to comment on it in great detail. However, it certainly seems to be unusual in light of the general reluctance to enforce non-competition clauses, even where the terms are less onerous than in the case.

Miller Thomson's lawyers would be pleased to discuss these issues with you in more detail and assist you in protecting your organization

*This article has been adapted from an article that appeared in *Canadian Employment Law Today.*

PROPERTY TAXES AND CHARITABLE ORGANIZATIONS*

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In Ontario, as in most other provinces, municipal property tax is payable by landowners. However, Ontario (again, like other provinces) has a system of exemptions from and rebates for real property taxes that are available to charitable organizations.

Exemptions

Under section 3 of the Ontario *Assessment Act*, lands owned by certain charitable organizations are not subject to property assessment and taxation. The exemptions most relevant to charities are those available to lands owned, used and occupied by:

(i) The Canadian Red Cross Society;

(ii) The St. John Ambulance Association;

(iii) any charitable, non-profit philanthropic corporation organized for the relief of the poor if the corporation is supported in part by public funds;

(iv) seminary of learning; and

(v) houses of worship.

In light of recent case law, the reference to "occupied" set out in the exemption has been given a broad interpretation to include those properties that are not physically occupied by staff of the charitable organization. In the predecessor to section 3, the property simply was required to be "occupied and used for the purposes of the institution". Notwithstanding the apparently more limiting scope of the language currently used in section 3, courts have adopted an interpretation of "occupied" that closely resembles the requirement of the previous language. In *Ottawa Salus Corporation v. Municipal Property Assessment Corporation*, (discussed in the February 2004 issue) it was held to be sufficient for the property to be controlled, held and employed by the charitable organization as a necessary prerequisite and means to fulfill its charitable mandate.

Rebates

For those charitable organizations that own real property and cannot take advantage of the specific exemptions set out in the *Assessment Act* or those that lease or occupy space in industrial or commercial buildings, the Ontario *Municipal Act* sets out a mandatory rebate program which allows qualified charitable organizations to recover a portion of property taxes paid or amounts paid on account of property taxes.

The main highlight of this rebate regime is the requirement that municipalities rebate a minimum of 40% of the taxes or amounts on account of taxes paid by an eligible charity on the industrial or commercial property that it occupies. A charity is eligible if it is a registered charity under the *Income Tax Act* (Canada).

Other relevant mandatory requirements of such rebate programs as set out in the *Municipal Act* are as follows:

(i) The program must provide that payment of one-half of the rebate be made within 60 days after the receipt by the municipality of the application of the eligible charity for the rebate for the taxation year and the balance of the rebate must be paid within 120 days of the receipt of the application.

(ii) The program must permit the eligible charity to make an application for a rebate for a taxation year based on an estimate of the taxes or amounts on account of taxes payable by the eligible charity on the property it occupies.

(iii) The program must provide for final adjustments, to be made after the taxes or amounts on account of taxes paid by the charity can be determined, in respect of differences between the estimated rebate paid by the municipality and the rebate to which the charity is entitled.

(iv) An application for a taxation year must be made after January 1 of the year and no later than the last day of February of the following year.

The Municipal Act also gives municipalities the authority to provide rebates in excess of 40% or to expand the availability of such rebates to organizations that are similar to eligible charities or a class of such organizations defined by the municipality. In addition, municipalities have the ability to provide rebates to eligible charities occupying properties within any class of real property. Not surprisingly, very few municipalities have yet to take advantage of this power to expand the rebate program beyond the mandatory minimum requirements.

In order to take advantage of this rebate program, an eligible charity must obtain and complete an application form from its local municipality. In a two-tiered municipality, the lower-tier municipality is required to administer the rebate program and to give the rebates. Applications forms can be obtained by contacting the local municipality directly or, in larger communities, by downloading the appropriate form from the municipality's website. No fee is charged by a municipality to process the rebate application.

In addition to providing a registered charity number, those applicants renting or leasing eligible premises will be required to provide documents from their landlord or the property owner specifying the amount of property taxes payable for the units occupied by the charity. Applications for any particular taxation year must be submitted by the last day of February of the following year. Eligible charities must also apply every year for the rebate as each application is only valid for that particular taxation year.

If eligible, the charitable organization should expect to receive at least one-half of the rebate within 60 days of filing of the application, with the balance to be received within 120 days following filing of the application. Interest is applied on any amounts not paid by the municipality within these time periods.

Although the details differ, all other Canadian jurisdictions also have charitable exemptions from property tax.

*Based on an article published in *Lawyers Weekly*.

AROUND MILLER THOMSON

Susan Manwaring published "CRA releases guidance on issuing receipts where donor receives partial consideration" in *The Lawyers Weekly* in early March.

The February issue of *Canadian Not-for-Profit News* included the following articles by **Arthur Drache:** "Canadians Focus on Tsunami Relief", "Senate and Commons Committee Budget Suggestions", "New Information Regarding Charitable Recipts", "New UK Charity Commissioners" and "New CRA Policy on Related

Business" as well as "The Mechanics of the New Disbursement Quota" by **Susan Manwaring** and "Federal Telemarketing Legislation Proposed" by **Andrew Roman**.

The March issue of *Canadian Not-for-Profit News* included the following articles by **Arthur Drache:** "Disbursement Quota Changes Will Require New Approaches", "Policy on Umbrella Groups Coming", "Same Sex Marriage Debate Should Trigger Political Activity Review", "Mechanics of Canadian Tsunami Aid Questioned", "Budget Comments in Next Issue", "Federal Not-for-Profit Act Raises Fundamental Questions" and "Uncertainty Over Security Hurts Muslim Charities in US" as well as "Court Considers Application of PIPEDA to Non-Profit Club" by **Rachel Blumenfeld.**

The March issue of *Charitable Thoughts*, published by the Ontario Bar Association Charity and Not-for-Profit Law Section, included an article by **Michael Piaskoski,** "Competition Law Remedies Against “Sound Alike Charities”, an article by **Elizabeth Gillis,** "Dissolution of Canada Corporations Act Companies for Failure to File", an article by **Lysane Tougas,** "CRA Continues to Expand Testamentary Gifts" and an article by **Susan Manwaring,** "Official Donation Receipts - Certainty for New Rules 2005?"."

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