

# CANADIAN NOT-FOR-PROFIT NEWS

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## Corporate Wind-Ups: Recent Developments

Daniel Frajman

The factors to consider when determining what a non-profit ("NPO") or charity incorporated federally, in Ontario or in Quebec<sup>1</sup> can do with its net assets upon dissolving or winding up, have taken on even more importance in light of recent or upcoming changes to corporate law in several Canadian jurisdictions,

<sup>1</sup> Certain aspects of three corporate statutes will be looked at, being (i) the *Canada Not-for-profit Corporations Act* (the "NFP Act"), which came into force on October 17, 2011, and under which pre-existing federal non-share capital corporations should take steps to continue during the subsequent three-year period to avoid dissolution, (ii) the *Ontario Not-For-Profit Corporations Act, 2010* (the "ONCA"), which is scheduled to be proclaimed in force on July 1, 2013, and (iii) Part III of the *Quebec Companies Act* (the "QCA"), an older letters patent statute which at present is not scheduled for replacement. Note that existing Ontario corporations have a three-year period from proclamation of the ONCA to comply with it, although after the three years, articles and by-laws not in compliance with the ONCA will be deemed as amended in a manner that conforms to the ONCA. (See, regarding transition to the ONCA and NFP Act, Linda J. Godel, "The New Not-for-Profit Corporations Acts", (2012) 24 *The Philanthropist* 235.) Reference in this article to a corporation means a corporation without share capital.

and recent Canada Revenue Agency ("CRA") interpretations and guidance relating to NPOs<sup>2</sup> and registered charities.<sup>3</sup> In particular, some of the possible rights of members to assets of the corporation that is winding up will be looked at below.

### The Corporate Legislation

The *Canada Not-for-profit Corporations Act* (the "NFP Act"), when dealing with the distribution of net assets on dissolution, in essence requires corporations that have solicited donations and similar financial assistance from the public or governmental sources (greater than \$10,000 in a year at any time over the previous five years)<sup>4</sup> to distribute net property on wind-up to qualified donees under the *Income Tax Act* (the "ITA") (i.e., to registered charities, mostly).<sup>5</sup> For corporations not soliciting at that level, the NFP Act usually provides leeway to

<sup>2</sup> See generally the CRA release of August 27, 2012, titled "Non-Profit Organization Risk Identification Project" (at <http://www.cra-arc.gc.ca/tx/nnprft/nprp-eng.html>), and CRA technical interpretation 2009-0337311E5 (November 5, 2009).

<sup>3</sup> For example, CRA guidance CG-016, "Qualified donees – Consequences of returning donated property" (issued October 19, 2012).

<sup>4</sup> This goes beyond the definition of a "soliciting" corporation at s. 2(5.1) of the NFP Act (and s. 16 of the regulations thereunder), which refers to three years rather than five years.

<sup>5</sup> Section 235 NFP Act, and s. 37 of the regulations thereunder.

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Editor: Arthur B. C. Drache, C.M., Q.C.  
 Content Editor: Steve Hostetter  
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Editorial Offices:  
 226 MacLaren St., Ottawa K2P 0L6  
 Phone: (613) 237-3300 x11  
 Fax: (613) 237-2786  
 Email: [adrache@drache.ca](mailto:adrache@drache.ca)  
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One Corporate Plaza, 2075 Kennedy Road,  
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 Tel: (416) 609-3800 from Toronto  
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the corporation to distribute its net assets on wind-up to the members of the corporation.

The Ontario *Not-for-profit Corporations Act* (the "ONCA") may be similar in this regard in many respects. In a nutshell, "public-benefit" corporations under the ONCA, on liquidation, must distribute their net property to charities and/or corporations with similar purposes to their own. "Non-public benefit" corporations under the ONCA have leeway to distribute net assets on wind-up to the members of the corporation.<sup>6</sup>

This situation also seems similar for a company governed by the Quebec *Companies Act* (the "QCA"), even though the QCA appears to provide the statutory right to distribute net assets

to members on wind-up.<sup>7</sup> This is because the administrative position of the Quebec corporations branch (the Enterprise Register) appears to be that if an organization is a charity or solicits funding from the public, then the organization's wind-up clause should call for net assets to be distributed to organizations of a like nature.<sup>8</sup>

For corporations formed under any of the above mentioned three statutes, a member may always have the right, at least under corporate law or private law, to receive back property that the member had transferred to the corporation on the condition that it be returned on dissolution of the corporation. A rule to this effect is set out in the NFP Act,<sup>9</sup> and at least one writer has observed that this is a rule of "universal application".<sup>10</sup>

### The Tax Legislation

If the corporation is a charity, the ability to distribute property to a member is greatly limited, notwithstanding the above mentioned possibilities to carry this out under corporate or private law.

In this regard, the CRA requires a dissolution clause to indicate that a charity can only transfer its remaining assets to a qualified donee upon dissolution.<sup>11</sup> A recent CRA guidance is along the same lines, as follows: "In rare and unique circumstances, there may be a legal requirement for a donee to return a gift. As a general rule, however, a registered charity cannot return a gift. The *Income Tax Act* requires a registered charity to devote its resources exclusively to its charitable purposes and activities, and prohibits it from making gifts to non-qualified donees."<sup>12</sup>

As for NPOs, paragraph 149(1)(l) ITA sets the tone for limiting distributions to members (and has led to the conventional wisdom being that an NPO's articles should have net assets distributed on liquidation to organizations carrying on similar activities) by requiring that the NPO be organized and operated for any purpose except profit, and that no income of the NPO should be available for the personal benefit of a member. For at least the last three years or so, a number of CRA interpretations may have further tightened these requirements.<sup>13</sup>

Nevertheless, there may be some room for distributions to members of an NPO. For example, it has been pointed out that there is a definition of "income" in subsection 149(2) ITA which excludes from income capital gains, and that a

<sup>7</sup> Sections 28(2) and 31 QCA.

<sup>8</sup> Quebec Enterprise Register, "Comment constituer une personne morale sans but lucratif" ("How to Constitute a Non-Profit Corporation") (October 2010), in French, p. 15. Note, as a separate point relating to confidentiality, that QCA by-laws do not have to be filed with the Quebec corporations branch.

<sup>9</sup> Section 234 NFP Act, which refers to a "person" (which presumably includes a member) having transferred property to a corporation on condition that it be returned on dissolution.

<sup>10</sup> Wayne Gray, *The Annotated Canada Business Corporations Act* (Carswell, looseleaf), at p. 7-143.

<sup>11</sup> CRA policy CSP-015, "Dissolution Clause" (revised March 9, 2009).

<sup>12</sup> CRA guidance CG-016, *supra*, note 3.

<sup>13</sup> *Supra*, note 2.

<sup>6</sup> Section 150 ONCA.



distribution of a non-profit's capital gains should not be a violation of the requirements necessary to preserve NPO status (although the member's taxable capital gain would have to be calculated).<sup>14</sup> Note though that to the extent that such capital returned constituted a reserve of assets held by the NPO, it may be relevant that the CRA has recently said, in one of its several recent technical interpretations possibly tightening NPO requirements, that although an NPO "may maintain a reasonable reserve...the reserve must be for identifiable operating purposes or for a specific future capital project".<sup>15</sup>

The better view concerning a wind-up clause for an NPO (at least for an NPO incorporated or continued under the NFP Act) may be that it often read as follows:

Any property remaining on liquidation after the discharge of any liabilities of the Corporation (the "Net Property") shall be distributed to one or more organizations carrying on similar activities, except that if required by the *Canada Not-for-profit Corporations Act* the Net Property shall be distributed to one or more qualified donees within the meaning of the *Income Tax Act* (Canada).

In conclusion, notwithstanding new and old corporate legislation referring to circumstances in which assets can be distributed to a member on wind-up, this seems rarely possible when the corporation is a registered charity. There may be more leeway to distribute to members when an NPO is wound up, and if such a distribution is desired and does not threaten the NPO's non-taxable status, there may be a need to amend the NPO's wind-up clause prior to proceeding.<sup>16</sup>

*Daniel Frajman is a shareholder at the law firm of Spiegel Sohmer Inc. in Montreal, and can be reached at dfrajman@spiegelsohmer.com or 514-875-8949.*

14 Arthur Drache, "Distributions on Winding Up a Non-Profit Corporation", *Canadian Not-For-Profit News*, September 1994, p. 71. See also CRA IT-409 (archived), "Winding Up of a Non-Profit Organization". See also CRA technical interpretations 2009-0332161E5 (August 14, 2009) and 2009-031086117 (August 25, 2009) regarding situations where the distribution from the NPO may be seen as a taxable dividend to the recipient (if the recipient member has rights more akin to a "shareholder").

15 CRA technical interpretation 2011-040885117 (March 30, 2012).

16 See Drache, *supra*, note 14. However, if the NPO is contractually bound to return property previously contributed to it, and assuming this does not threaten the NPO's status, the NPO might be able to proceed without amending its wind-up clause. (See generally Gray, *supra*, note 10).

## Briefly Noted in March

**Budget Date Set:** Finance Minister Jim Flaherty will table the new budget on March 21st. Our own instincts are that there will be little if anything in terms of tax breaks to the sector but there could be more tweaking of rules in the name of "transparency". Spending cuts are sure to be in the budget and some of these will have either a direct or indirect effect on the not-for-profit sector.

But Flaherty and his predecessors have often surprised us, both positively and negatively, with unexpected initiatives and that could happen again this year.

**Chief Economist to the Sector:** Imagine Canada has appointed Mr. Brian Emmett to the unique role of chief economist for the charitable and non-profit sector.

Tasked with measuring the impact of the sector and bringing economic issues facing charities and nonprofits to the forefront of public policy decision makers, Mr. Emmett will analyze and provide advice about related policies, programs and legislation.

Mr. Emmett is an economics graduate of the University of Western Ontario and the University of Essex in England, and has enjoyed a long public service career. He was Canada's first Commissioner of the Environment and Sustainable Development in the late 1990s and worked extensively on Canada's Green Plan. He also served as Vice-President of the Canadian International Development Agency (CIDA) in the early 2000s and has been an Assistant Deputy Minister in a number of federal government departments.

His early priorities will include connecting with key influencers within government and the charitable and nonprofit sector, providing ongoing economic impact estimates of policy proposals, and undertaking original research about the sector's contribution to Canada's economy.

Imagine Canada has secured funds from the Muttart Foundation, the Ontario Trillium Foundation, the Vancouver Foundation, and an anonymous donor to hire the Chief Economist for the Charitable and Nonprofit Sector. Additional support has been provided by the PricewaterhouseCoopers Canada Foundation.<sup>1</sup>

This is obviously a new position and it speaks to the self-importance of Imagine Canada to arrogate to itself the right to bestow the title of Chief Economist to the Sector upon somebody who is apparently an employee of Imagine Canada. However, we can see no harm in this job creation notwithstanding the grandiosity of the title.

**McInnes Retires:** Barbara McInnes, President & CEO of the Community Foundation of Ottawa, has announced that she will be stepping down after a quarter-century of serving the philanthropic cause in Ottawa. She provided a full year's notice to the Foundation's Board of Governors in February to conduct a proper search for a replacement and to allow for a smooth transition to the new leader. A press release states:

Helping to found the Community Foundation of Ottawa in 1987 with her father, Alastair Gamble, its first Executive Director, Barbara has led the organization since 1991. In that time, she has overseen its growth to what is one of the largest and most highly regarded of Canada's 183 community foundations. Managing an endowment worth more than \$90-million, the Foundation has provided over \$65-million in grants to the community since its inception.

Among her many accomplishments, Barbara was awarded the Order of Canada in 2008 for her contributions as a leader and

1 <http://www.imaginecanada.ca/node/2356>.