

Benched

Heritage Committee Vindicates the Court Challenges Programme

The cancellation of a myriad of programmes as part of an ostensible budget cutting exercise by the federal government now seems like history given that it happened in late September. But we are pleased to note that not everybody has forgotten. In the first week of February, the Heritage Committee of the Commons tabled a report dealing with the cancellation of the Court Challenges programme...and concluding that the cancellation was bad policy.

The Conservatives were a minority on the Committee but, insofar as we can determine, the report was unanimous. The report made the following observations.

- That it came to light that the reasons cited by the government to justify cancelling the Program were unjustified;
- That all of the witnesses stated that the political allegiance or non-allegiance of the lawyers was never a factor in the hiring of lawyers;
- That the vast majority of the groups stressed the importance of this type of program for minority groups living in Canada;
- That the federal government has an obligation to promote and protect the equality rights of disadvantaged persons in Canada;

That the cancellation of funding for the Court Challenges Program of Canada, announced on September 25, 2006, has had negative impacts.

All that having been said, the report did not explicitly call for the re-instate-

ment of the programme, perhaps because it is obvious that no such thing is likely to occur under this government.

The full report can be found at: <http://cmte.parl.gc.ca/cmte/committeepublication.aspx?sourceid=190120&lang=en>

Bring That Bill Back

Shareholders Agreements for Private Foundations¹

by Daniel Frajman*

Corporate legislation governing private charitable foundations does not yet allow for unanimous shareholders agreements ("USAs"), and a previous attempt by the federal government to reform the law in this area, by way of a bill which had been introduced but not passed in the last Parliament, should be reactivated.

Unanimous Shareholders Agreements

Corporate jurisprudence going back to at least the early 1900s had held that agreements such as USAs, which were characterized as "fettering" the directors' power to manage the corporation, were at risk of being invalidated. Rather, directors generally could manage at their discretion so long as they acted in the best interests of the corporation.

The *Canada Business Corporations Act* of 1975 (the "CBCA") changed the playing field in this regard for business corporations (see present s. 146(1) CBCA), with the enactment of a statutory rule indicating that a unanimous agreement among the shareholders can override the management authority of the directors. Most provincial corporate statutes contain a similar rule. (For example, s. 123.91 of the *Quebec Com-*

panies Act and s. 108(2) of the *Ontario Business Corporations Act*.)

Private Foundations

USAs are not yet available however to private foundations. A brief review of the purpose and structure of private foundations underlines the importance of trying to extend USAs to them, and also shows that more attention should be paid to the corporate by-laws of private foundations.

A private foundation (regulated in many respects by sections 149 and 149.1 of the federal *Income Tax Act*, or "ITA") is a registered charity and as such is exempt from income tax. It usually receives its funds primarily from one individual or corporation or related group (for example, from an opening lump sum donation from the founder shortly after organization and registration of the private foundation). That founding donor receives a charitable tax receipt from the private foundation in an amount equal to that lump sum donation. In the ensuing years, the private foundation carries out its charitable purposes, in many cases by simply making donations over time from the income and capital of that lump sum to so-called public charities (charitable organizations and public foundations). The private foundation is therefore a philanthropic vehicle used by many large donors.

As to structure, the ITA requires a private foundation to be operated out of a corporation or trust, with the corporation being the method of choice probably due to its familiarity and flexibility. The corporation in question, rather than being a business corporation, is a corporation without share capital (i.e., it does not issue shares, and has *members* rather than shareholders).

At the federal level, and in jurisdictions such as Quebec and Ontario, corporations without share capital are not incorporated under the general corporate statute, but rather are formed under older statutes, such as, federally, Part II of the old *Canada Corporations Act* (a "Part II

¹ A previous version of this article appeared in *The Lawyers Weekly* of January 26, 2007.

Federal Corporation"). (For the Quebec and Ontario statutes, see respectively Part III of the Quebec *Companies Act* and Part III of the Ontario *Corporations Act*.) The ITA is indifferent as to which of these corporate statutes is used, and they each provide for a relatively familiar corporate structure, with members (not shareholders) electing directors (who manage the corporation's affairs), and the directors appointing officers. Memberships are usually issued for a nominal fee. The founding donor referred to in the above example is usually one of the members and directors of the public foundation, and most of the directors are usually related parties.

The Need for Change

Unfortunately, these older corporate statutes are antiquated in many respects. For example, they do not provide for USAs (or what would more properly be referred to as "unanimous members agreements"), and the federal statute does not allow for unanimous written resolutions to replace members' or directors' meetings. (The Ontario statute does allow for such unanimous written resolutions, and the Quebec statute allows them for directors' meetings.)

In response to this, and after consultation with the charitable sector, the federal government tabled a bill on November 15, 2004, titled *An Act Respecting Not-for-Profit Corporations and Other Corporations Without Share Capital* ("Bill C-21"), which would have remedied these and many other problems in the older corporate statutes. For example, s. 170(1) of Bill C-21 contained the following rule:

"An otherwise lawful written agreement among all the members of a corporation . . . that restricts in whole or in part, the powers of the directors to manage, or supervise the manage-

ment of, the activities and affairs of the corporation is valid."

Bill C-21 stated that this rule applied only to "non-soliciting corporations," defined essentially as corporations that do not request donations from the public and do not receive government funding. Therefore, one of the effects of this rule would have been to allow most private foundations to have USAs. Bill C-21 further stated that Part II federal corporations existing at the time of Bill C-21 coming into force would have three years to continue under the new law, or otherwise face possible dissolution.

Unfortunately, Bill C-21 died on the order paper when the Martin government fell in November 2005, and Industry Canada has recently indicated that it does not know when the bill will be re-introduced, let alone passed.

Until there is legislative change of this nature, keep in mind that an agreement that would be interpreted as restricting the powers of the directors of a private foundation may be interpreted as being a USA, and therefore invalid. A possible example of this is a list drawn up by the members stipulating how the private foundation is to invest its assets, or setting out the future donations to be made by the foundation.

The unavailability of USAs under the above-mentioned current federal, Quebec and Ontario statutes, highlights that extra care should be given to the preparation of a private foundation's corporate by-laws, in particular as regards the conditions required to be a member, and the transferability of a member's interest. The current federal, Quebec and Ontario statutes appear to allow these matters to be dealt with by the private foundation's charter and/or by-laws, and Bill C-21 also seems to have taken this approach (ss. 154 to 157). A good starting point for

preparing the by-laws for private foundations is Industry Canada's model by-law for Part II Federal Corporations, and its draft by-law concerning Bill C-21, both of which can be found at Industry Canada's website www.strategis.gc.ca.

Marketable Securities

Modernization of the corporate statutes dealing with private foundations, along the lines of Bill C-21 or something similar, is a goal worth pursuing. One way this need will become more acute is if the use of private foundations becomes even more widespread, which would occur, for example, if the rules under the ITA allowing the tax-free transfer to public charities of appreciated marketable securities are extended to transfers made to private foundations.²

Even if such rules are not extended in this way, there is the possibility that the ITA will be amended (see the Notice of Ways and Means Motion of November 9, 2006) to allow public charities to receive most of their funds from one person or a related group, so long as more than 50 percent of the directors of the charity are at arm's length with each other.³ Such a charity, especially if it is non-soliciting as this would have been known under Bill C-21, might benefit from a USA in the same manner as would a private foundation.

**Daniel Frajman is a partner at Spiegel Sohmer Inc. in Montreal. His practice concentrates on commercial, shareholder and estate matters. He may be reached at dfrajman@spiegel-sohmer.com*

² "Buffet Gift Should Be a Spur to Flaherty," *The Canadian Taxpayer*, August 8-28, 2006, pp. 121-122.

³ "Foreign Trust and Charity Legislation Finally on Road to Enactment," *The Canadian Taxpayer*, December 5-31, 2006, pp. 185-186.