

TRUSTS VS. CORPORATIONS: PART I

Daniel Frajman

Editor's Note: This is the first part of a two-part article. The second part will appear in the next issue of The Canadian Taxpayer.

The recent modernization of corporate law for federal non-share capital corporations underlines that corporations, rather than trusts, will likely continue to be the vehicle of choice for non-profit organizations and charities. This article will discuss some of the more important differences between corporate and trust vehicles in this context, with a description of some of the unique aspects of trusts in Quebec. In this regard, because there is some uncertainty in Quebec relating to how to amend trusts, and relating to the degree of detail needed in describing a trust's purposes or objects, the attractiveness of using trusts for non-profits and charities in Quebec is even further reduced.

The Trust Option

Notwithstanding that the roots of Canadian charity law can be found in English charitable trusts dating back several centuries,¹ and that currently trusts are often used outside of North America for charitable purposes, the corporate rather than trust model is the vehicle of choice for Canadian non-profits and charities. The reasons for this are perhaps not well thought out, and in this regard it has been observed, "The commercial world, particularly banks, are unfamiliar with the workings of trusts. Thus, using corporations becomes the norm."²

However, there has been recent commentary in common law Canada to the effect that the trust option should be re-examined and used if appropriate for

non-profits and charities,³ and this in light of the potential desire of some organizations to avoid new corporate statutes for non-share capital corporations that are either recently in force or on the horizon.⁴ In essence, this commentary supporting the re-examination of trusts is along the following lines:

- The federal *Income Tax Act* ("ITA") does not bar the use of trusts;⁵
- Some basic trust restrictions are often inapplicable to charitable trusts (for example: the rule against perpetuities seldom applies; a charitable trust can be created for a "purpose" and need not have a specific beneficiary);
- Trusts have flexibility, since the trust need not follow corporate rules, and the settlor can allow the trustees to set their own operational rules;
- Unless the trustees choose to have one, there are no audit requirements;
- Trustees can often be explicitly allowed to act at their discretion within broad guidelines;
- Even though the charitable trust makes public filings with the CRA, privacy is provided by there being no public corporate record;⁶
- Some administrative layers can be removed, as, unlike with respect to non-share capital corporations, there is no need for members and directors, since simply the trustees operate the trust;⁷
- The trust deed itself can be amended by following the rules in the document, whatever they may be.

Also worth noting is that the "21-year rule" under the ITA,⁸ providing every twenty-one years

1 See discussion of Iacobucci J. in *Vancouver Society of Immigrant & Visible Minority Women v. M.N.R.*, [1999] 1 S.C.R. 10, [1999] 2 C.T.C. 1, at paras. 142 to 153.

2 Arthur Drache, "Trusts as an Organizational Option", *Canadian Not-for-Profit News*, June 2011 at page 43.

3 See Drache, *ibid.*; Arthur Drache, "Revisiting Charitable Trusts as an Organizational Option", CBA National Charity Law Symposium (May 6, 2011); Arthur Drache, "Members Have Rights so Why Have Members?", *Canadian Not-for-Profit News*, November 2009 at page 81; and Tamara Wong, "Charitable Trusts: Another Option to Establish a Charity", BLG Newsletter (September 14, 2011).

4 The *Canada Not-for-profit Corporations Act*, S.C. 2009, c. 23 (the "NFP Act") came into force on October 17, 2011. Ontario's *Not-for-Profit Corporations Act*, S.O. 2010, c. 15 (the "ONCA") received Royal Assent on October 25, 2010, but it is not yet in force.

5 Subsection 149.1(1) ITA (definitions of "charitable organization" and "charitable foundation").

6 However, on occasion in Quebec, lenders have required trusts to register under the corporate registration statute, *An Act Respecting the Legal Publicity of Enterprises*, R.S.Q., c. P-44.1 (under which registration is currently voluntary for trusts).

7 Federal, Quebec and Ontario non-share capital statutes provide that the corporation's members (not shareholders) appoint the board of directors. See Daniel Frajman, "Modernization of Corporate Laws on Private Foundations Needs to Continue", January 26, 2007, *The Lawyer's Weekly* at page 8, and "Shareholders Agreements for Private Foundations", *Canadian Not-for-Profit News*, March 2007 at page 23.

8 Subsections 104(4), 104(5) and 104(5.2) ITA.

for a deemed disposition of certain trust assets at fair market value, and tax on the resulting capital gain, would not affect a non-profit or charity, which should be non-taxable entities.⁹

In a nutshell, some may view a trust as useful if control and administration through one person is desired, in the context perhaps of a private foundation.¹⁰ For public charities, on the other hand, there may be a desire to incorporate rather than use a trust so as to, among other things, have transparency through corporate governance, and potentially invoke the corporate veil in relation to director/administrator liability (although it seems that there are few reported cases of directors' liability in the charity context, other than in cases of statutory liability for unremitted government levies).¹¹

For a precedent common law trust deed for charitable trusts that can be adapted as required, see Arthur Drache's paper submitted at the 2011 Canadian Bar Association's National Charity Law Symposium (the "2011 Symposium Precedent").¹²

The Quebec Trust

With respect to private law issues, but not necessarily tax aspects, trusts governed by Quebec law are conceptually different than trusts under the common law.

Although under both a Quebec and common law trust, the trust property is separate from that of the settlor, dedicated to a purpose, and administered

by a trustee,¹³ Quebec law does not distinguish between legal and beneficial ownership.¹⁴ Rather, the CCQ refers to a trust as a separate "patrimony" that is "appropriated to a particular purpose", with neither the settlor, trustee nor beneficiary having a "real right" (akin to a right in property) in the trust property (articles 1260 to 1265 CCQ).

One result of this is that the standard common law declaration of trust, a variation of which is found in the 2011 Symposium Precedent, by which property is held in trust by and vested in trustees, does not fit the terms of the CCQ. To address this issue, it might be best when approaching common law precedents for Quebec purposes, to add in at least minimum language that incorporates the abovementioned Quebec concepts.¹⁵ However, it should be noted that some authors maintain that the differences between common law and Quebec trusts are minor in terms of their function, creation and administration, and that as long as there are the "three certainties" (certainty of intention, certainty of subject matter and certainty of objects), there is likely a Quebec trust, even if the particular words from Articles 1260 to 1265 CCQ are not used.¹⁶

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⁹ Subsection 149(1)(i) ITA for non-profits, and subsection 149(1)(f) for charities.

¹⁰ The ITA requires, for public charities, an arm's length group of directors, trustees or like officials, hence the need for at least three directors or trustees. For a private foundation however, the ITA would permit there to be one trustee (although in Quebec, article 1275 of the *Civil Code of Quebec* ("CCQ") would prevent the one trustee from also being a settlor or a beneficiary). Nevertheless, for incorporated private foundations, and all other incorporated non-share capital entities, the corporate statutes have traditionally required at least three directors (see s. 155(1)(e) of the *Canada Corporations Act*, s. 83 of the *Quebec Companies Act*, and s. 283(2) of the *Ontario Corporations Act*).

¹¹ *Supra*, note 2. See also Arthur Drache, "Director Liability Insurance", *Canadian Not-for-Profit News*, February 2008 at page 15, and Arthur Drache, "Directors' Liability for Source Deductions", *Canadian Not-for-Profit News*, March 2009 at page 23.

¹² Drache, "Revisiting Charitable Trusts as an Organizational Option", *supra*, note 3.

¹³ Alissa K. Gabel and Marilyn Piccini Roy, "Common Law Trusts Versus Quebec Trusts", *Personal Tax and Estate Planning* (2010), Vol. III, No. 2, at page 126.

¹⁴ For example, *Tucker v. Royal Trust Co.*, [1982] 1 S.C.R. 250.

¹⁵ One possibility would be to add the following clause, adapted as required, to a trust meant to be governed by Quebec law but which is otherwise drafted in common law terms: "Any trust created herein shall in accordance with the provisions of Articles 1260 and following of the *Civil Code of Quebec* (as from time to time amended) constitute a separate patrimony constituted by the settlor by which the settlor appropriates to such separate patrimony for the particular purpose or purposes as herein provided with respect to such particular trust, property which is autonomous and distinct from that of the settlor, trustees, beneficiary or beneficiaries thereof, in which none of the settlor, trustees, beneficiary or beneficiaries have any real right, and to which the trustees undertake by his, her or their acceptance to hold and administer in accordance herewith."

¹⁶ Gabel, *supra*, note 13; John B. Claxton, *Studies on the Quebec Law of Trust* (Carswell, 2005), at paras. 3.6 and 3.23.

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TRUSTS VS. CORPORATIONS: PART II

Daniel Frajman

Editor's Note: This is the second part of a longer article. The first part appeared in the immediately prior issue of The Canadian Taxpayer.

The main problem then in using a Quebec trust for charitable or non-profit purposes appears to be as follows, namely that the Quebec authorities are not clear as to how easily such a trust can be amended, and are not clear as to how much precision is needed in drafting the objects or purposes of such a trust. The relevant issues that arise in this regard appear to be as follows:

- A charitable trust under the *Civil Code of Quebec* (referred to as a "social trust") can be amended by court order so as to "substitute another closely related purpose for the original purpose of the trust" (art. 1294 CCQ; this is apparently an adaptation of the common law *cy-près* doctrine);
- However, aside from such an amendment as to purpose, other amendments (as to trustees, administrative issues, etc.) appear problematic, because firstly, it remains undecided in the Quebec cases and commentary as to whether an amendment can proceed without court

¹ The CCQ does not use the term "charitable trust", but rather at art. 1270 refers to a "social trust", which has "a purpose of general interest, such as a cultural, educational, philanthropic, religious or scientific purpose".

intervention based on an amending formula in the trust deed, or whether instead a court order is needed for all amendments,² and secondly, should a court order be needed, the attitude of the courts may be that, except when applying Quebec's abovementioned adaptation of the *cy-près* doctrine for amendments as to purpose, an amendment to the trust will only be granted by the court in rare cases.³

- As to how much precision is needed when drafting the objects or purposes of a charitable (social) trust, the required precision may have recently shot up, based on the recent Quebec Superior Court decision of *Aubé v. Béland*,⁴ where in *obiter*, a clause providing for benefits to "various charities"⁵ was found to be too ambiguous and equivocal to be valid. The court appeared to be of the view that for a charitable (social) trust, it is necessary for the trust deed to set out with some specificity the nature, character and purpose of the trust.

The Letters Patent Option

There may be at least some advantage in using the non-share capital letters patent model for a non-profit or a charity, which remains available for the foreseeable future, at least under the Quebec corporate legislation.⁶

With respect to a non-profit incorporated under the Quebec legislation (Part III of the Quebec

Companies Act), one has to put up with delays for the receipt of the letters patent (up to one month from the submission of an application), and the persistent possibility that the *ultra vires* doctrine applies to the corporation (rendering absolutely null acts exceeding the capacity of the corporation).⁷ Furthermore, although unanimous written directors' resolutions can substitute for meetings of directors, unanimous members' resolutions cannot substitute for a members' meeting.⁸

However, if a corporation is to be used, it may be that the main advantage of using this Quebec corporation is that there is no requirement to publicly file its by-laws. To the extent that the by-laws contain provisions that merit a degree of confidentiality, this is a positive element of this letters patent option.⁹

The NFP Act Option

On balance, the NFP Act, in force since October 17, 2011,¹⁰ will be a popular non-share capital option, for a number of reasons, including:

- The amendment and interpretation of corporate articles should not be subject to the same difficulties that may face trusts, and especially Quebec trusts;
- Incorporation is as of right through articles of incorporation,¹¹ and the corporation has the capacity and rights of a natural person.¹² By-laws

2 Marc-Antoine Deschamps, "La modification unilatérale de l'acte de fiducie : possibilité ou fiction?" ["Unilateral Amendment of a Trust Deed: Fact or Fiction?"], BYB2010REP974 (August 2010).

3 *Poulin v. Poulin*, 2010 QCCS 2928, 2010 CarswellQue 6641; *Trust Scotia v. La Roque de Roquebrune*, 2007 QCCA 171, 2007 CarswellQue 4971. Furthermore, if a charitable (social) trust loses that charitable status, perhaps because it provides undue private benefit, it would apparently lose the ability to access Quebec's abovementioned adaptation of the *cy-près* doctrine for amendments as to purpose. On this latter point, see John B. Claxton, *Studies on the Quebec Law of Trust* (Carswell, 2005) at para. 14.102.

4 2010 QCCS 431, 2010 CarswellQue 9566. See reference to this case in Marilyn Piccini Roy, "Powers of Appointment: Civil Law and Common Law Comparisons", (2011) 30 *Estates, Trusts & Pensions Journal* 344 at 346-7.

5 The basic objects of most private foundations.

6 See the *Canada Not-for-profit Corporations Act*, S.C. 2009, c. 23 (the "NFP Act") regarding the recent disappearance federally of the letters patent option, and its imminent departure in Ontario: *Not-for-Profit Corporations Act*, S.O. 2010, c. 15 (the "ONCA"), not yet in force. In Quebec, a similar change is not imminent, as the Quebec government has apparently not moved on its October 2008 consultation paper, "Réforme: Droit des associations personnalisées" ["Reform: Not-For-Profit Corporations"] (Quebec Ministry of Finance).

7 Paul Martel and Georges A. Lebel, *La Corporation sans but lucratif au Québec* ["Not-for-Profit Corporations in Quebec"] (Editions Wilson & Lafleur Marcel Ltée; looseleaf through July 2011) at pp. 6-5 and 6-9.

8 See Daniel Frajman, "Modernization of Corporate Laws on Private Foundations Needs to Continue", January 26, 2007, *The Lawyer's Weekly* at page 8; and Frajman, "Shareholders Agreements for Private Foundations", *Canadian Not-for-Profit News*, March 2007 at page 23.

9 Similarly, a letters patent corporation currently formed under the *Ontario Corporations Act* is not required to publicly file its by-laws. Interestingly, under Ontario's new ONCA, where articles of continuance or of incorporation will replace the letters patent, neither continuing nor new corporations will be required to publicly file their by-laws. See Wayne D. Gray, "The New Federal v. Ontario Not-For-Profit Incorporation Choice", CBA National Charities and Not-For-Profit Law Newsletter (on-line), November 2011, and see generally, Joel Sector, "The Other New Act in Town", *Canadian Not-for-Profit News*, October 2011 at page 77.

10 Non-share capital organizations previously incorporated under Part II of the *Canada Corporations Act* ("CCA Corporations") (the "CCA") must by October 17, 2014 continue under the NFP Act via articles of continuance (ss. 211 and 297(5) NFP Act). CCA Corporations can still amend their letters patent under and are otherwise governed by the CCA prior to continuing under the NFP Act.

11 Section 6 NFP Act. Certificates of incorporation are being issued within five working days.

12 Section 16 NFP Act.

need not be approved by Industry Canada (unlike under the CCA), but must be filed with Industry Canada within 12 months of being confirmed by the members.¹³ To assist in preparing by-laws under the NFP Act, Industry Canada has issued a precedent by-law in electronic form, that can be used and adapted as required.¹⁴

- Unlike under the CCA, unanimous directors' or members' resolutions will be able to replace actual meetings;¹⁵
- "Non-soliciting" corporations can have one director, rather than a minimum of three. (Generally, a non-soliciting corporation solicits less than \$10,000 per year in donations from the public or from government grants. A private foundation therefore should usually be a non-soliciting corporation, but other charities would usually be considered as "soliciting" corporations under the NFP Act. Soliciting corporations require at least three directors, two of whom are not officers or employees.)¹⁶ Therefore, a "one-person" organization is possible.¹⁷ Furthermore, non-soliciting corporations can fetter the discretion of directors and regulate management through a unanimous member agreement;¹⁸
- Generally, the need to appoint an auditor will apply only to soliciting corporations;¹⁹
- The CRA's minimum content requirements for charities in articles of incorporation or continuance are not particularly onerous (but are

probably not yet completely settled, and should be monitored);²⁰

- As a *caveat*, since members have voting rights and remedies that are analogous to those held by shareholders (regarding fundamental changes, oppression remedies, etc.), consider reviewing by-laws (prior to continuance or incorporating) to remove membership status where warranted. It has been observed that some supporters might not even want to be members and should not be referred to as such.²¹

Therefore, the NFP Act apparently is an attractive option in all provinces, and especially in Quebec where the trust option seems to have particular drawbacks and where the provincial non-profit letters patent statute may not always be appropriate. The trust option does have its place for Canada's non-profits and charities, but recent amendments to the corporate statutes appear to indicate that corporations will continue to be the vehicle of choice in this area.

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¹³ Section 153 NFP Act.

¹⁴ The precedent by-law is at http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/h_cs04734.html. The precedent is brief, and therefore relies on the default provisions of the NFP Act. Regarding by-law preparation, see generally Jane Burke-Robertson and Linda J. Godel, "Here Comes the CNCA: Are You Ready to Advise Your Clients", CBA National Charity Law Symposium (May 6, 2011).

¹⁵ Sections 140 and 166 NFP Act.

¹⁶ See generally the CRA guidance at <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtg/nfpc/fm4031-eng.html> (the "CRA Guidance"), and s. 2(5.1) NFP Act.

¹⁷ Compare with Ontario's new ONCA, which always requires three directors. Gray, *supra*, note 9.

¹⁸ Section 170 NFP Act. For example, a private foundation might set out investment and disbursement decisions in advance in a unanimous member agreement. Frajman, *supra*, note 8; and British Columbia Law Institute, "Consultation Paper on Proposals for a New Society Act" (August 2007) 75-6.

¹⁹ Industry Canada provides details on this in a table concerning required levels of financial review, at <http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs05010.html>.

²⁰ See the CRA Guidance, *supra*, note 16. Additionally, the CRA verbally advised this writer that Item 3 of the articles of incorporation can refer to the possibility of one director for a private foundation, and that Item 5 of the articles of incorporation, referring to the corporation's restrictions on activities, can be filled in as "none". See also Joel Sector, "CRA Provides Guidance to Charities Continuing Under the New Federal Act", *Canadian Not-For-Profit News*, January 2012 at page 1.

²¹ See three articles by Arthur Drache, "Trusts as an Organizational Option", *Canadian Not-for-Profit News*, June 2011 at page 43; "Revisiting Charitable Trusts as an Organizational Option", CBA National Charity Law Symposium (May 6, 2011); and "Members Have Rights so Why Have Members?", *Canadian Not-for-Profit News*, November 2009 at page 81.