


**LEGAL CONSIDERATIONS FOR
INDEPENDENT SCHOOLS**
10 Traps and Tips

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Development Conference

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CEDAR SPRINGS CHRISTIAN RETREAT CENTER

KEN VOLKENANT
De Jager Volkenant & Company



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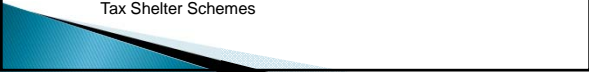
Charity & Non-Profit Organization Law
Wills and Estates
Corporate and Commercial Law
Real Estate Development
Employment and Human Rights Law
Litigation and Mediation
School Law

#5 – 15243 – 91 Avenue
Surrey, British Columbia, V3R 8P8
Tel: (604) 953-1500 Fax: (604) 953-1501
kvolkenant@dvclawyers.com



INTRODUCTION
10 Issues That Lead To Trouble

- ▶ Director Duties and Board Dynamics
 - Failure to Understand Duties and Role of a Director
 - Failure to Recognize and Deal with Conflicts of Interest
 - Inadequate Board Succession Planning
 - Ineffective Use of External Advisors
- ▶ Corporate & Contract Matters
 - Failure to Deal with Constitution, Bylaw & Membership Issues
 - Inadequate Consideration of Insurance and Asset Protection
 - Improper Solicitation of Investments
- ▶ Charity Matters
 - Failure to Ensure Basic Charity Compliance
 - Failure to Maintain Direction & Control
 - Improper Fundraising & Participating in Abusive Tax Shelter Schemes



Director Duties and Board Dynamics
1. Duties and Role of a Director

- ▶ **Basic Duty of Care**
 - Act *honestly* and in *good faith* and *in the best interests of the charity*
- ▶ **Basic Standard of Care**
 - a director must “exercise the care, diligence and skill of a reasonably prudent person, in exercising the powers and performing the functions as a director”
 - This is a *minimum* standard

Director Duties and Board Dynamics
1. Duties and Role of a Director

- ▶ **Problem Areas we have encountered**
 - Directors appointed to “represent” external interests (chapters, regions, employees, parents, donors etc.)
 - Confidentiality requirement
 - Solidarity requirement (speaking with One Voice)
 - Directors who are also employees
 - Statutory consideration
 - Charity, Trust and Common Law considerations
 - Bylaw consideration

Director Duties and Board Dynamics
1. Duties and Role of a Director

Some Good Questions to Ask of your Charity:

- ▶ **Who is in Charge?**
 - Is the *defacto* control of the Charity with the Board or with Management/Executive Staff?
 - is the Board's Authority recognized by the Membership?
- ▶ **Are there clearly defined lines of control between the Board and Management?**
 - e.g. – hiring of staff
- ▶ **Does the Board meet on a regular basis and do directors regularly attend meetings?**

Director Duties and Board Dynamics
2. Conflicts of Interest

- ▶ Identification:
 - situations in which a Board member's interests (personal, professional or financial) or those of a friend, family member, colleague or professional association *might*:
 - interfere with the exercise of such member's judgment and/or
 - impair such Board member's ability to act in the best interest of the charity,
 - for which the person is morally required to either:
 - *avoid* or
 - *openly acknowledge*

Director Duties and Board Dynamics
2. Conflicts of Interest

- ▶ A conflict of interest exists where outside interest has the *potential* of being in variance with the best interests of the charity.
- ▶ When a board member's personal interests, *whether real or perceived*, could supersede or conflict with his or her dedication to the best interests of the charity, a conflict arises.
- ▶ The test of a conflict of interest is not just whether the board member is actually influenced by a personal interest, but *whether circumstances lend themselves to such a possibility*. Examples include:

Director Duties and Board Dynamics
2. Conflicts of Interest

- ▶ Conflicting financial interests
 - Charity hires Director's Firm for Consulting Services
- ▶ Use of confidential information for personal gain
 - Director acquires real estate that will benefit from charity's plans
- ▶ Use of institutional time and facilities without charge for personal purpose or other activities
- ▶ Note that the *appearance* of a conflict of interest, when in fact it may not exist, can still be damaging to the charity.

Director Duties and Board Dynamics
2. Conflicts of Interest

- ▶ Disclosure of Conflicts/Potential Conflicts
 - Always err on the side of disclosure
 - Once disclosure made, deliberate on whether:
 - the conflict must be avoided or
 - whether the action could be approved
- ▶ Discussion regarding Conflicts
 - Director disclosing conflict or identified as being in conflict should recuse himself/herself from Board discussion regarding conflict
- ▶ Approval of Actions
 - Director in conflict should not participate in a vote approving action that creates a conflict/potential conflict
- ▶ Adopt a Formal **Conflict of Interest and Disclosure Policy** and refer to it (i.e. make it an annual agenda item)

Director Duties and Board Dynamics
3. Inadequate Succession Planning

- ▶ Terms and successive term limits
 - Length of terms should balance time needed to learn organization and need for new ideas
- ▶ Staggered Terms
 - Keep board turnover consistent year to year
- ▶ Recruitment
 - Establish nominating (or governance) committee
 - Limit floor nominations
- ▶ Finding Board Balance
 - Skills, Vocations, Gender, Constituent Perspectives etc.

Director Duties and Board Dynamics
3. Inadequate Succession Planning

- ▶ Education of New Board Members
 - Consider mandatory continuing education
 - Consider regular in-servicing
 - Develop a Board Manual
 - History
 - Vision/Mission
 - Constitution & Bylaws
 - Policy manual/Key Policies
 - Previous Board Minutes

Director Duties and Board Dynamics
4. Ineffective use of External Advisors

- ▶ Retain General Counsel/General Advisors for Organization (Legal/Financial/Public Relations etc.)
- ▶ Obtain specific written opinions from external advisors for critical Board issues
- ▶ Be careful about reliance on Board members who are professionals
 - Due diligence defense benefit
 - Extra insurance

Director Duties and Board Dynamics
4. Ineffective use of External Advisors

- ▶ Particular Legal Problem Areas (where obtaining outside expertise is **strongly** encouraged):
 - Employment and Human Rights Issues
 - Membership discipline/termination
 - Charity compliance issues and Audits
 - Consulting & Fundraising Agreements
 - Donation Schemes/Proposals

Corporate and Contract Matters
5. Constitution, Bylaw & Membership Issues

- ▶ **Constitutions and Bylaws**
 - Purposes that adequately encompass *Activities*
 - List activities and check against purpose language
 - May need to add:
 - Advancement of Religion
 - Relief of Poverty
 - 4th Head purposes
 - Statements of Faith/Mission/Purpose
 - Have them!!! Incorporate into constating documents
 - Continuance/Transition Compliance
 - New Societies Act in force in BC
 - Annual Filings/Corporate Status
 - Consider external Professional Office to maintain Records and to attend to filings

Corporate and Contract Matters
5. Constitution, Bylaw & Membership Issues

- ▶ Bylaw review (or Governance) committees
- ▶ Common Bylaw Issues for Review
 - Member qualification and disqualification
 - Director qualification, election/appointment and removal
 - Quorum
 - Director Remuneration
 - Indemnification of Directors
 - Dispute resolution provisions
 - Restrictions on inspection of documents

Corporate and Contract Matters
5. Constitution, Bylaw & Membership Issues

- ▶ Membership Issues
 - Do you know who your members are?
 - Do you have any of these?:
 - Honorary Members
 - Life Members
 - Voting and Non-Voting members
 - Note Society Act restriction
 - Members "not in good standing"
 - Membership fees
 - Annual declarations
 - **Update and approve your Membership list annually**

Corporate and Contract Matters
6. Insurance and Asset Protection Issues

- ▶ Insurance Issues
 - maintain a historical record of insurance coverage
 - provide full disclosure of all risks to your insurer to avoid denial of coverage
 - request regular reports from insurance broker on existing coverage, exclusions from coverage and request recommendations to enhance coverage
 - ensure regular review of the adequacy and extent of general liability coverage and property insurance
 - Confirm directors' and officers' liability coverage in place and review on a regular basis
 - Report, Report, Report

Corporate and Contract Matters

6. Insurance and Asset Protection Issues

- ▶ **Asset Protection Strategies**
 - Operational Due Diligence
 - Insurance
 - Incorporation
 - Multiple Incorporations
 - Consider separating particularly risky aspects of operations
 - Consider separating independent operations within a single entity
 - Consider legal separations where there are multiple locations

Corporate and Contract Matters

7. Soliciting Investments

- ▶ **Charities may seek investments because:**
 - Donation opportunities exhausted
 - Borrowing from institutional lenders unavailable
 - Cost of borrowing from institutional lenders is prohibitive
 - Large capital projects create opportunities
- ▶ **Are investments being offered to the public without full disclosure to potential investors?**

Corporate and Contract Matters

7. Soliciting Investments

- ▶ **Types of Investments**
 - Unsecured debt instruments/Promissory Notes
 - Bonds, secured and unsecured
- ▶ **Investment programs offered by charities including the above likely constitute the sale of securities and are therefore likely subject to securities legislation**
- ▶ **Confirm Exemptions:**
 - Prospectus Filing
 - Dealer Registration

Corporate and Contract Matters

7. Soliciting Investments

Sale of Investments - Exposure to Liability:

- ▶ Failure to advise investors of unregulated nature of securities being offered
- ▶ Failure to disclose reasonable details of investment such as
 - Purposes for which monies are being raised
 - Explaining fully the security being offered
 - Explaining the nature of the risks associated with the investments
 - Explaining Investment Returns accurately

Corporate and Contract Matters

7. Soliciting Investments

- ▶ False or misleading statements about financial strength of charity
- ▶ Suggesting Investments are secure when they are not
- ▶ Failure to recommend that potential investor first obtain independent tax and legal advice
- ▶ Failure to Disclose actual or pending financial crisis

Charity Matters

8. Basic Charity Compliance

- ▶ **Incorrect Issuance of Receipts**
- ▶ **Failure to File T3010**
- ▶ **Non-Charitable Activities**
 - These usually emerge when a Charity expands to undertake new programs or as the Charity's focus shifts
 - Charities must restrict activities to the realm of what is considered charitable. Doing good work in the community does not necessarily qualify as charitable (sports, community building events)
 - "Public Benefit" requirement – private benevolence is *not* charitable

Charity Matters

8. Basic Charity Compliance

- ▶ **Gifts to Non-Qualified Donees**
 - Charity's tend to be unaware of restrictions surrounding Qualified Donees
 - Only 2 options available for using resources (whether received on not):
 - To support Charity's own charitable programs and activities
 - Gifts to Qualified Donees
 - Common mistakes that we see:
 - Gifts to foreign charities
 - Gifts to not-for profit societies in Canada that carry on similar activities but that are not Registered Charities

Charity Matters

9. Maintaining Direction and Control

- ▶ Often Charities operating in foreign jurisdictions carry out activities through an agent or other intermediary
- ▶ Where activities are carried out through an intermediary the Charity must maintain direction and control over the use of its assets
- ▶ A properly structured arrangement (containing all the necessary elements required by CRA) helps to demonstrate direction and control
- ▶ Frequently, even when an agreement is in place, charities fail to properly implement and monitor the arrangement

Charity Matters

10. Fundraising and Tax Shelter Schemes

- ▶ **Fundraising**
 - From the media's perspective this is the #1 compliance issue
 - Read CRA Policy on Fundraising
 - CRA accepts that charities can have fundraising costs, however the expectation is that these expenses will be *reasonable and proportional* to the charitable activity being conducted
 - A charity that expends excessive amounts on fundraising to the detriment of its charitable programs is not considered to be devoting **all** of its resources to charitable activities

Charity Matters

10. Fundraising and Tax Shelter Schemes

▶ **Tax Shelters**

- The popularity of tax shelters has increased dramatically – serious concern at CRA
- Since 2003 estimated 137,000 donors and \$4.6 Billion in donations
- Audits of taxpayers at various stages. "Substantial" disallowed donations already and more are expected
- Charities involved in these schemes may face revocation – several have already been revoked

Charity Matters

10. Fundraising and Tax Shelter Schemes

▶ **Fraudulent Charities**

- Ongoing issues with individuals "selling" tax receipts
- CRA discovering that receipts are sometimes being sold by individuals employed by the charity without the charity being aware
- CRA encouraging diligence in safeguarding receipts and reporting suspected fraud to CRA

Charity Matters

10. Fundraising and Tax Shelter Schemes

▶ **Tax Scheme Red Flags:**

- the arrangement is being proposed by a promoter that seems to already have everything in place - all they are looking for is a charity, any warm charity, to plug into the deal
- "donors" seem to appear out of nowhere, with no, or only passing, interest in the work of your charity
- the overall arrangement seems to be extremely complicated, even if your charity's part in it is not
- the arrangement seems to require (and have) tax opinions from prestigious (and expensive!) law or accounting firms to justify or support it

Charity Matters

10. Fundraising and Tax Shelter Schemes

▶ **Tax Scheme Red Flags:**

- the arrangement includes goods that are notoriously hard to value, or that have dramatically different values in different contexts (e.g. works of art, vaccines and medications)
- there seem to be a whole lot more dollars ending up in promoters' and others' pockets than in your own (even if the dollars ending up in your pocket are beyond your wildest dreams!)
- the money is ultimately coming from a lender, rather than the donor, or it is not even clear where the money is coming from
- the cash your charity will eventually have on hand as a result of this scheme is a small percentage of the tax receipt value that you will have written

Thanks for Attending!

Your Questions Welcomed

kvolkenant@dvclawyers.com

604-953-1503
