



Ontario Government Proposal to Allow Compensation of Directors of Charities Without Court Order

By Mark Blumberg (August 29, 2017)

In the middle of summer 2017 the Ontario government decided to put forward a proposal that board members of Ontario charities can be compensated for services provided to the charity. With all the issues facing the charity sector what a peculiar proposal to see.

We have the Ontario government about 7 years behind with the new Ontario *Not-for-Profit Corporations Act, 2010* (ONCA). There has been no word on when ONCA will come into force. We have overly complicated grants and contribution arrangements which are vital to the sector and little progress in improving them. We have a provincial cy pres scheme which is very narrow and makes it very difficult to change restricted gifts, even if the donor and charity agree on the change, unless the right to make changes was reserved in the gift document. There are so many areas of potential legislative and administrative improvement that this focus on paying board members for services is a bit surprising.

Current Law

Currently the rule in Ontario, as noted in an earlier [article](#), is that generally an Ontario charity, whether a registered charity or not, cannot compensate its directors for either serving as a director or for performing other services for the charity. Directors have fiduciary duties and a “duty to act gratuitously”.

This does not apply to many non-profits that are not charities. There are also a few exceptions that we understand the PGT accepts even with charities. First, public hospitals in Ontario are excluded from this rule and they have a president on the board who is compensated. Second, if one person or a family sets up a fund (typically a private foundation) and it is set up as a trust and the trust document allows for compensation of trustees then the PGT will accept this. This is for trusts, not corporations, which are

only receiving funds from one family and not from the public. This is commonly used by banks to administer private foundations.

Some Favour Flexibility to Compensate

If one thinks that allowing compensation of some directors of charities for non-director work is inevitable then there are some good ideas in the regulation.

The argument for allowing some compensation of a board member is that in some communities there is a small group of people interested in the charitable organizations, such as a church, and the organization wants the best board members but at times those people also have skills or talents that the organization needs for certain non-board functions. The examples given are usually small payments – such as \$2,000 per year for a very involved choir leader who happens to sit on the board.

Having the proposal is a reminder that the general rule is that trustees or directors of charities cannot be compensated. If the proposal is adopted it will certainly be a reminder of the general rule.

Discussed below are a number of seemingly positive aspects of the proposal and also how they are not as positive as one may think.

The proposal does not allow compensation for employees of the charity or for Directors as directors (as opposed to services rendered or goods sold to the charity). This may encourage some “employees” to become independent contractors to avoid this prohibition. The PGT will have to expand the definition of employee to include independent contractors who spend a substantial portion of their time on the work of the charity.

For compensation of a director to take place there must be at least 5 directors in the corporation. The assumption appears to be that if the organization has five engaged, knowledgeable and committed board members there will be proper deliberation on the issue. Generally, charities have to have at least 3 directors. As we know, practically speaking there are organizations where there are 5 or more directors and really one of the directors are running the show and the others are rubber stamping the activities. Having seen both good and bad governance in the sector, there will be cases where having 5 directors is not much of a check.

Only 1 in 5 directors can receive compensation. So if the charity wants 5 directors to all be compensated, another 20 “directors” need to be added to the board who all consent to the compensation of the 5 directors. One can guess that the “executive committee” is going to be busy and the new 25-person board is probably not going to be meeting that often!

The decision to compensate requires unanimity which is good (except that the one dissenting director may be replaced at an upcoming AGM or special meeting.) So this is probably not that great a safe guard.

The proposal does not require ongoing unanimity. There is no limit in terms of time. There is no cap on amounts. So if, for example, the 5 directors on a board of an Ontario charity approve a fifteen year printing deal for \$500,000 per year for a company owned by one of the directors, and 6 months later there is an AGM and 4 of the directors are replaced with new directors, the new directors are not required to approve the arrangement and if they disapprove of the arrangement and try to cancel it they may potentially have a huge lawsuit on their hands for the lost profits of the company over the remainder of the 15-year period.

There is an attempt to have some transparency in that the payments need to be reported at the AGM and in the financial statements. However, there is a common misconception that financial statements are publicly available. Most are not unless you make a request to CRA if the charity is a registered charity. Furthermore, many organizations have only one or two members or perhaps their members are the same as the board, which is quite common. Having the members be told about it in these circumstances may not be a real safeguard.

Concerns with the proposal

Right now the rule around compensation is quite simple. If you want to be compensated, except in rare circumstances, it is straightforward – resign from the board of the charity. You can still be involved in many other positions within the charity. I believe this proposal is killing simplicity with a complicated, subjective system.

Aside from the complexity, the issue is whether the benefit of paying some people who are directors of charities will outweigh the damage that may befall the charity sector by abuses of the provision.

Here are some other quick points:

1. The proposal blurs the line between board/trustees, who have a policy and fiduciary role, and staff who implement and receive compensation.
2. With the new complicated rule charity staff may be pressured by one or more board members that they should be compensated for their previously non-board volunteer activities. Staff may become more suspicious of board members that they may be looking for avenues to provide compensated services.
3. When some board members are compensated and others are not it will inevitably cause difficulty amongst board members – even if the board member has approved the engagement.
4. Board members who are professionals may get pressure from their own firms to try to provide services that can be charged to the charity.
5. The proposal encourages people with a non-philanthropic outlook to join a charity board.

6. The proposal will probably reduce public confidence in charities as there is a strong view in the public that board members should be contributing to the charity, financially or in terms of expertise, and not be taking funds from the charity as compensation.
7. As noted above, even if the directors change, the arrangement continues. If new directors try to terminate the arrangement then the charity could face a lawsuit.
8. The proposal will allow for lawyers, accountants and investment advisors to be compensated. These are people who, if serving as directors of a charity, are fiduciaries but, more importantly, having the knowledge and reputation they are relied on more by other members of the board, especially on certain types of activities or questions. These are the well-off members of society that one precisely does not want to have this type of conflict of interest arise.
9. There does not seem to be any process whereby, for example, there should be a public tendering of the work. So it will not be public and there will inevitably be questions around fairness when a small connected group will make the decision to benefit one of their own.
10. It is difficult enough for charities to evaluate performance of regular staff but imagine the added pressure of evaluating the effectiveness of the work of a paid director who can have a say in the hiring and firing of the senior staff. Who is going to evaluate whether the charity is getting value for money?
11. This is probably the thin edge of the wedge making charity governance similar to for profit governance when it is not helpful - first allowing payments for board members who do work for charities and then later allowing payments for all board members because they are also doing work for charities!

Although there are seemingly many safeguards in the proposal, as discussed there are many concerns about these safeguards.

Why are we dealing with this proposal? Is it perhaps because a director wants to be able to manage a \$50 million endowment and also be compensated by receiving perhaps \$500,000 per year for such management services? However, the amount could be far greater if it is a hedge fund and charging a percentage of the increase in the portfolio. Is it because the chair of the board, who is a lawyer and a partner of a prestigious large Canadian law firm, would like to send work to his firm and his partners and they would now be able to be paid? If you get into a fight with CRA an appeal of such CRA decision all the way to the Supreme Court of Canada, if you have the right facts, can cost about \$1.2m. It might be that the \$1.2m is "reasonable" in particular circumstances. Unfortunately, it is a little ironic that if a charity is involved with reckless behaviour then there is a greater likelihood of legal entanglements and this could be advantageous on a personal and financial level to the board member and his law firm if the firm is going to be handling such legal issues.

Improvements

If the proposal is to move forward, here are some suggestions for improvements:

- In the case of compensation of directors, the financial statements of such charities should be required to be easily publicly available on the website or social media of a charity and contain the necessary disclosures on these types of arrangements.
- a maximum amount for using the procedure should be capped at say \$10,000. Alternatively, if the payment is greater than the cap a detailed filing should be sent to the PGT outlining the arrangement., Even if the PGT does not have to approve it, at least they are aware of it and if it appears to be egregious then the PGT could act.
- The arrangement should not be in perpetuity but should have to be revisited and reapproved every year.
- The proposal excludes fundraisers and real estate agents. At a minimum, it is suggested that lawyers, accountants and investment advisors should also be excluded from being compensated under these rules.
- The prohibition generally on paid employees being on the board should apply to “staff” of the organization who devote significant time to the charity, not just “employees”, or it will encourage some “employees” to be re-labelled independent contractors.
- There should be certain standard contractual terms provided by the PGT which would establish reporting and evaluation to enhance the likelihood that the services will be delivered appropriately and also allow the charity to terminate the contract for any reason without any penalty.

Conclusion

It will be interesting to see how many contributions are received by the Ontario government on this issue of paying directors and what the organizations have to say.

Some organizations, especially larger and more complicated ones that want to thank a board member but not pay them, instead allocate some funds for discretionary grants to registered charities. This allows the board member to make a gift to another charity they also care about but it does not result in a personal benefit to the board member. But fundamentally a person should join a board for reasons such as to help improve society, meet other people concerned with a similar issue, etc. and not to make a financial gain.

Charities play an important role in our society and one needs to be very careful that the proposal, if implemented, do not undermine good governance.

<http://www.ontariocanada.com/registry/view.do?postingId=24430&language=en>

Charities Accounting Act - Approved Act of Executors and Trustees

Regulation Number(s):

4/01

Bill or Act:

Charities Accounting Act

Summary of Proposal:

The regulation would authorize incorporated charities to pay their directors and persons related to them, for goods, services, or facilities, without obtaining a court order, provided specific conditions are met. It would also address the need to ensure that the payments are made in the best interests of the charitable corporation.

The regulation balances the need for charities to enter into advantageous transactions with the need to protect the public's interest in ensuring that charitable property is not misused.

Not every kind of payment would be authorized by the regulation. The regulation would not authorize direct or indirect payments for:

- Services provided by a director as a director or employee of the charity;
- Fundraising services or selling goods or services for fundraising purposes; or
- The purchase or sale of real estate.

The regulation would require charities to meet the following conditions before payments could be made to a director or persons related to a director:

- i. The payment must be made with a view to the charity's best interests;
- ii. The payment must be in an amount that is reasonable for the goods, services or facilities provided;
- iii. The payment must not result in the amount of the debts and liabilities of the charity exceeding the value of the charity or render the corporation insolvent;
- iv. Before the board may authorize the payment:
 - a. Every director must agree in writing to the maximum amount that can be paid for the goods, services or facilities;
 - b. Every director, other than the director receiving the payment, must agree in writing that that they are satisfied that the conditions set out in the regulation have been met, and
 - c. The board must consider any guidance issued by the Public Guardian and Trustee;
- v. There must be at least five directors on the board;
- vi. Neither the director who will receive the payment, nor any person related to them, can take part in the deliberations, attend any part of a board meeting during which the decision to authorize the payment is discussed or participate in any vote of the board on the issue;
- vii. The number of directors receiving remuneration, or who are connected to persons receiving remuneration, cannot be greater than 20% of the total number of directors in any fiscal year; and
- viii. The payment to the director must be reported at the annual general meeting and must be noted on the charity's financial statements.

Payments made to a not-for-profit corporation or a corporation wholly owned by the charity, would be exempt from the regulation if no director of the charity or a person connected to a director, received a benefit from the payment. For instance, a charity could make payments to a wholly owned subsidiary if no benefit was received by the charity's directors or persons connected to them.

Further Information:

 [Charities Accounting Act](#)

 [O. Reg. 4/01: APPROVED ACTS OF EXECUTORS AND TRUSTEES](#)

 [Consultation Draft](#) ([Download Adobe Reader](#))

Proposal Number:

17-MAG008

Posting Date:

July 10, 2017

Comments Due Date:

August 29, 2017

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[Comment on this proposal via email](#)

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