MINDEN GROSS LLP

Fall 2012

TOPICS:

Canada and Ontario's New Not-for-Profit Legislation
What Changes Should You Expect?

The law has drastically changed for the not-for-profit (**"NFP"**) corporation with the enactment of the *Canada Not-for-Profit Corporations Act* (**"CNCA"**) and the passing of the *Ontario Not-for-Profit Corporations Act* (**"ONCA"**). CNCA came into force on October 17, 2011 and it affects NFPs incorporated federally. ONCA is expected to come into force on July 1, 2013 and will affect all NFPs incorporated in Ontario.

Prior to the enactment of CNCA, federal NFPs were incorporated under and governed by the *Canada Corporations Act* (**"CCA"**). Ontario NFPs are currently incorporated under and governed by the *Ontario Corporations Act* (**"OCA"**).

ONCA and CNCA are modeled on the *Ontario Business Corporations Act* (**"OBCA"**) and the *Canada Business Corporations Act* (**"CBCA"**), respectively, which govern business corporations. This harmonization of the NFP and for-profit rules will help clarify areas of the NFP legislation that previously lacked certainty, through the reference to settled cases in relation to business corporations.

The following is a selective summary of the more important aspects of both CNCA and ONCA.

Ontario Not-For-Profit Corporations Act

Under ONCA regime, once the Act comes into force, there is an automatic continuance of existing corporations. A corporation will have three years to amend its by-laws to conform to ONCA, after which, the by-laws will be deemed to have been amended in accordance with the Minister's template by-law (not yet published). If the corporation is newly formed, it will have 60 days after formation to approve a new form of by-law that conforms with the Act, otherwise the Ministry form will apply.

ONCA corporations may provide in their articles for a minimum or maximum number of directors or a fixed number of directors, but there is a minimum requirement of three directors.

ONCA reflects an objective standard of care as opposed to a subjective standard of care for directors and officers. The OCA does not speak on the subject of standard of care for directors and left the matter to the courts to interpret. This standard of care is now in tune with the standard of care for business corporations found in the OBCA and CBCA.

The enactment of ONCA also brings clarity to several areas of director responsibilities that were not clearly provided for in the OCA. Under ONCA, a director must be appointed as the chair of the board of directors. Also, ONCA specifically disallows a director to send a delegate to a directors' meeting in his or her place.

In addition to the benefits that are afforded to NFP corporations and their officers and directors as a result of ONCA, there are also additional rights and remedies that are available to members. Amongst other provisions, the Act dictates that the by-laws must set out the requirements to become a member of the corporation and also that any termination of such membership must be done in good faith and in a fair and reasonable manner. The OCA did not provide several of the member remedies which are now available through ONCA. These member remedies now include an application for a compliance or a restraining order by a complainant or creditor, an application by an aggrieved party to have the registers or records of a corporation rectified, a dissent and appraisal remedy for certain corporations, the ability of a complainant to seek a court order for the commencement of a derivative action, and the holder of 10% of the votes may requisition a meeting of members.

Canada Not-For-Profit Corporations Act

Under CNCA, every NFP corporation incorporated under the CCA will have until October 17, 2014 to continue under CNCA, failing which, it will be dissolved. Under the CCA, Industry Canada must approve any by-law. A CNCA corporation will now have to file copies of their by-laws with Industry Canada within 12 months of confirmation by the members but these by-laws will no longer need to be approved by Industry Canada.

All CNCA corporations must have a minimum of one director. If however the corporation is a soliciting corporation, as defined in the Act, it must have a minimum of three directors, at least two of which must not be officers or employees. It is also necessary under CNCA for the articles of the corporation to specify a fixed number or a minimum and maximum number of directors. Like ONCA, the CNCA also reflects an objective standard of care as opposed to a subjective standard of care for directors and officers.

While there are many similarities between CNCA and ONCA, there are also several provisions that are different. For example, ONCA specifically permits *ex-officio* directors[1], while CNCA disallows this practice and provides that directors must be elected by ordinary resolution of members at the annual general meeting. Also, under CNCA, the by-laws may provide for decisions to be made by consensus as long as this term is defined, while ONCA is silent on this point.

A major difference between ONCA and CNCA is the fact that under CNCA, members may enter into a unanimous members agreement to restrict the powers of the directors, similar to unanimous shareholders agreements under both the CBCA and OBCA. In addition, CNCA provides for a derivative action remedy for members in certain situations. The holders of 5% of the votes may requisition a meeting of members.

Conclusions

1. This brief overview of CNCA and ONCA demonstrates the important changes to the legislative framework of NFP corporations in Canada. With the enactment of these two Acts, there will have been significant harmonization between the for-profit and NFP corporations.

2. Currently, NFP corporations are operating under outdated legislation that does not take into account modern corporate governance practices.

3. Directors, officers and members of NFP corporations should seek advice about the appropriate time for continuance (in the case of CNCA corporations) and start thinking about the changes that are needed to ensure that the corporation's governance arrangements are improved or updated to conform to the new legislation.

Hartley R. Nathan, Q.C.
Partner
416.369.4109
hnathan@mindengross.com

Ira Stuchberry
Student at Law
416.369.4331
istuchberry@mindengross.com

Minden Gross LLP can assist corporations to transition under CNCA and ONCA. Contact Hartley R. Nathan, Q.C. (hnathan@mindengross.com) or Aaron Grubner (agrubner@mindengross.com)

[1]There are complicated mechanisms to "circumvent" this prohibition against *ex-officio* directors.

WELCOME!

We are pleased to announce that **Eric N. Hoffstein** has joined the firm as Partner in the Litigation and Wills and Estates groups.

Eric joins us from Fraser Milner Casgrain LLP. Eric practices corporate and commercial litigation and dispute resolution with a special focus on trust, estate and charity/not-for-profit law, and construction and real property disputes. Eric has appeared as counsel at all levels of Ontario courts and at the Supreme Court of Canada.

Eric appears regularly before the Toronto Estates List. His broad experience in trust and estate disputes includes passing of accounts, will challenges, guardianships, dependant relief applications, interpretations, variations, rectifications, and related proceedings.

Eric's experience in construction, real property and commercial leasing disputes includes construction lien and trust claims, professional negligence, product liability, mining, land rights, boundary, and mortgage enforcement proceedings.

Canadians and U.S. Real Estate

On an individual's death, an estate tax is imposed in the US on both its citizens (based on their worldwide estates) and non-citizens (to the extent that they hold certain US-situs assets, including real estate therein). For US citizens (whether they live in the US or abroad), the first $5.12 million of worldwide assets are exempt from estate taxes, and worldwide assets in excess of this amount are taxed at a rate of up to 35%. Starting January 1, 2013, however, this exemption is scheduled to be reduced to $1 million and the estate tax rate is scheduled to increase to up to 55%. This is unless President Obama's proposed change to the estate tax regime becomes law (permanent exemption of $3.5 million and estate tax rate of up to 45%) or the Republicans win the upcoming election and introduce their own estate tax plan. (Individuals, however, should be wary of any change coming to fruition given previous instances involving the estate tax regime.) Non-US citizen Canadians who are subject to estate taxes, on the other hand, have their exemption "ground down" based on the proportion of their US-situs assets to their worldwide estate and are subject to estate taxes on the value of their US-situs assets in excess thereof. Thus, absent any changes, a Canadian's US-situs assets that comprise only 10% of his worldwide assets at death will only be entitled to an exemption of $512,000 in 2012 and $100,000 thereafter, and any US-situs assets in excess of this amount will be subject to estate taxes at a rate of 35% in 2012 or 55% thereafter.

So what's the impact of the estate tax on Canadians holding US real estate? Suppose Mr. Jackson has a worldwide estate of $15 million and is considering purchasing US real estate for $1.5 million or already owns US real estate worth $1.5 million. If the US real estate is Mr. Jackson's sole US-situs asset and if he holds it personally, on his death Mr. Jackson will be subject to estate taxes of roughly $345,800 in 2012; if he dies in 2013 or beyond, however, his estate tax will more than double to roughly $770,000.

Given the magnitude of those estate taxes, it's no wonder that many Canadians have been seeking alternative ways to hold US real estate to avoid estate taxes on death. Currently, one of the most frequent forms of alternative ownership is the use of a Canadian discretionary trust, the main, if not sole, purpose of which is to purchase and hold US real estate (whether from a third party or the individual himself). So long as the US real estate is held in this trust, the property will not form part of an individual's estate and thus no estate taxes will be owing upon death with respect to the property. This type of trust is most commonly settled and funded - with the amount necessary to purchase the

US real estate - by one spouse (the "grantor spouse") while the other spouse (the "trustee/beneficiary spouse") is often the sole trustee of the trust as well as a beneficiary thereof along with the couple's issue. (The trust may also be used in a number of other circumstances including situations where there is only one spouse who will act as the grantor spouse.) The trust provides for discretionary payments of income and/or encroachments of capital to one or more of the beneficiaries, but such payments/encroachments are limited to the "ascertainable standard" (health, support in reasonable comfort, maintenance or education) unless an "Independent Trustee" is then acting, who can make unlimited payments/ encroachments.

The major limitation of the trust is that the grantor spouse has no beneficial interest in the trust's property and can only use the US real estate – while it is held in the trust – with the trustee/beneficiary spouse while he/she is alive. If the trustee/beneficiary spouse is the first spouse to die (or if there was only one spouse initially), the grantor spouse must pay fair market value rent to the trust in order to use the US real estate. And while the trust structure can be unwound if necessary (by distributing the property to one or more of the beneficiaries of the trust), the grantor spouse (because he/she is not a beneficiary of the trust) will forever extinguish his/her right to the US real estate as well as the funds used to acquire it. Another limitation is that the trust's useful lifespan may be limited to 21 years as a result of certain Canadian tax laws that may give rise to significant Canadian tax consequences if the trust's property is not distributed prior to its 21st anniversary. However, a number of factors will have to be considered at that time as, among other things, the potential estate tax exposure may outweigh the Canadian tax that will be triggered upon the trust's 21st anniversary if the trust's property is not otherwise distributed.

When the US real estate has not yet been acquired, the use of a trust is relatively straightforward. Where US real estate is already owned, however, there are some additional factors that must be considered. In particular, capital gains taxes may be owing – in the US and/or in Canada – upon the sale of the property by the individual to the trust. In the US, long-term capital gains tax at a rate of 15% would be payable with respect to any gain (based on US values at the time of acquisition and time of sale) that is triggered upon the sale of the property. In circumstances that warrant the use of the trust, those US capital gains taxes will almost always pale in comparison to the potential US estate tax exposure.

Tax Tip: *The US long-term capital gains tax is scheduled to increase in 2013 (although the extent of this increase is currently unknown). Accordingly, it may be prudent for Canadians personally holding US real estate with accrued gains thereon to sell the property to the trust prior to the end of 2012.*

As for Canadian taxes, a capital gain will be triggered on the sale (taxed at a rate of up to almost 24% in Ontario in 2012) to the extent the fair market value of the US real estate (adjusted for the exchange rate at the time of the sale) exceeds its cost base (adjusted for the exchange rate at the time of acquisition). As a result of the adjustments, however, it is possible that no Canadian capital gains taxes will be owing upon the sale in spite of increases in the value for US purposes and it is likewise possible that Canadian capital gains taxes will be owing upon the sale even though there has been a decrease in value for US purposes. In any event, if Canadian capital gains taxes are owing on the sale, some or even total relief may be available (i.e., foreign tax credit, principal residence exemption).

For further information, please contact the author or any member of the Minden Gross Tax or Wills & Estates groups. Many thanks to Michael Goldberg of Minden Gross LLP and Katherine Cauley of Hodgson Russ LLP for their assistance in the preparation of this article.

Matthew Getzler
Associate
416.369.4316
mgetzler@mindengross.com

TAX PLANNING YOUR WILL PART 2

In Part 1 of this article that was in our Summer Newsletter, we discussed the use of multiple testamentary trusts in a Will for tax purposes and showed – through the use of an admittedly extreme example – the magnitude of tax savings that could be achieved through the use of such trusts. We suggested that instead of paying inheritances outright to spouses and/or issue, the use of such trusts, structured in a manner that is almost akin to holding the assets outright, can be a tax-effective form of estate planning. Part 2 of the article will explain the specifics of how these tax-planned trusts are drafted.

In order for a spousal trust to receive the rollover benefits under the *Income Tax Act,* all income generated in each year must be paid to the surviving spouse, and while there is no requirement to pay all of the underlying capital to the spouse, nobody other than the spouse can have a right to it while her or she is alive. Spousal trusts are most commonly used to protect assets for future generations and to maintain some control over the use of these assets during the surviving spouse's lifetime. In these circumstances, one or more independent trustees are appointed (which may be in addition to the spouse acting as a trustee) to provide this protection or control. However, in the case of a purely tax-planned trust, the spouse would be appointed as the sole trustee and would have the unfettered discretion to encroach on the entire capital of the spousal trust if he or she so desires. In this regard, the use of the tax-planned spousal trust is akin to paying the assets outright to the surviving spouse (as she has complete control of the assets), but its tax-planned nature has the additional benefit of establishing a testamentary trust that may enjoy annual tax savings. Upon the surviving spouse's death, the assets of the spousal trust would be divided among contingent beneficiaries in accordance with the testator's wishes contained in the Will. If the proposed multiple testamentary trust approach is utilized, the assets would be divided among the testator's children and/or grandchildren and added to the capital of their respective trusts if already established, or, where the testator chose to only use a spousal trust upon his death, separate testamentary trusts or a single discretionary family testamentary trust could be established upon the surviving spouse's death.

Like spousal trusts, tax-planned testamentary trusts established for the benefit of a single child or grandchild can similarly be drafted so that the assets are held in trust for the lifetime of the child or grandchild as opposed to having the assets distributed outright to such child or grandchild or at a certain age. If the testator's intention was to distribute the assets outright to the child or grandchild, the child or grandchild could be named the sole trustee of his or her own trust. Not only would this achieve maximum flexibility on the payment of income or capital to the child or grandchild (since he or she could encroach on the whole of the capital of the trust), but it would allow the child or grandchild to also take advantage of the trust's graduated rates. Alternatively, if the intention of the testator was to hold the assets in trust for such child or grandchild until attaining a certain age, the testator could appoint someone other than, or in addition to, the child or grandchild to act as trustee of the trust with discretionary income and capital encroachment powers. Upon the child or grandchild attaining a specified age, the child or grandchild could become the sole trustee of his or her own trust (at which point, he or she could encroach on the whole of the capital of the trust if he or she so desired). Like the spouse being the sole trustee of the spousal trust, having the child or grandchild act as the sole trustee of his or her trust (whether initially or upon attaining a certain age) allows the child or grandchild to enjoy the tax savings of a testamentary trust while providing him or her with the same flexibility to do as he or she pleases with the assets as if they had been paid outright to him or her.

Finally, as its name suggests, the single discretionary family testamentary trust discussed above established for the benefit of all children and grandchildren (and perhaps the spouse) as discretionary beneficiaries would provide the trustees of the trust with the discretion to determine who will receive income or capital from the trust, providing that distributions of income or capital can be made at any time to one or more family members to the exclusion of any or all of the others. Different beneficiaries can receive income and capital payments at various times. This structure can prevent an irresponsible child from misusing the funds, and may afford creditor protection for those beneficiaries that may require it. The choice of trustees for this type of trust can be a difficult one, given the multitude of beneficiaries and potential conflicts of interest. Therefore, the choice of trustees will depend on the testator's circumstances. Conversely, where multiple discretionary family testamentary trusts are being used for the benefit of each child and his or her issue, the choice of trustee becomes easier – typically the child of the testator is the sole trustee of his or her discretionary family trust.

Part 1 of the article illustrated the substantial annual tax savings that can be enjoyed through the use of multiple testamentary trusts in a Will. When these savings are combined with the flexibility afforded by these trusts (as described in Part 2), the result is a relatively simple and highly effective way of tax planning your Will to benefit your loved ones. It's worth a talk - "trust" us!

Matthew Getzler
Associate
416 369-4316
mgetzler@mindengross.com

Rachel Goldman
Associate
416 369-4105
rgoldman@mindengross.com

Firm News

We are pleased to announce that Benjamin Bloom (Business Law), Benjamin Radcliffe (Commercial Leasing), and Eli Kutner (Commercial Real Estate) have returned to the firm as Associates, September 2012

Minden Gross LLP Earns Recertification in Meritas, a Global Alliance of Business Law Firms, September 2012

Minden Gross is happy to announce a sponsorship with Sprouter, an online community for entrepreneurs to get answers to small business questions from people who know what they're talking about.

Minden Gross LLP

barristers & solicitors
145 king street west, suite 2200
toronto, on, canada m5h 4g2
tel 416.362.3711 fax 416.864.9223
www.mindengross.com

Professional Notes

Arnie Herschorn presented "What to Say and Do When Closing Problems Arise – The Litigators' Advice Panel" at the 9th Annual Real Estate Law Summit, April 2012

Arnie Herschorn published On the Measure of Damages in Solicitor's Negligence Claims in the Canadian Bar Review, March 2012

Adam Perzow, Michael Horowitz, Stephen Posen, Stephen Messinger, Reuben Rosenblatt and Howard Black have all been listed in Best Lawyers® in Canada, August 2012

Amy Cull is a regular contributor to Deadbeat, the Trust and Estate newsletter published by the Ontario Bar Association

David Ullmann was quoted in the Precedent Magazine article "Fitting It In: Lawyers talk about how to schedule in exercising time around long office hours", September 2012

Former New York City Mayor Rudy Giuliani spoke at a Grafstein Function hosted by The Hon. Jerry Grafstein, Q.C., September 2012

Joan Jung presented Trust Defence: A Practical Approach to CRA Audits at the 2012 Canadian Institute of Chartered Accountants National Conference on Income Taxes., September 2012

Howard Black appeared on The Pattie Lovett-Reid Show to discuss how to stop financial issues from becoming family feuds, September 2012

Stephen Posen chaired a panel for RealLeasing entitled "Legal, technical and financial Issues that can arise during the term of the lease", October 2012

Eric Hoffstein presented to the Ontario Bar Association on "Exercise of Discretion: Trust Controlled Corporations", October 2012

Members of the Commercial Leasing group participate in the ICSC Canadian Convention in Toronto, October 2012

Hartley Nathan Q.C. and **Phillip Bevans** will present "Contentious Issues at Board and Shareholder Meetings" to the Association of Corporate Counsel (ACC) Ontario Chapter, November 2012

Steven Pearlstein will present "Preparing to Comply with the Mortgage Pre-Payment Disclosure Rule Revisions" at the Canadian Institute's 18th Annual Regulatory Compliance for Financial Institutions conference, November 2012

Members of the Commercial Leasing group will present Dealing with the Lease in conjunction with Lexpert, November 2012

Samantha Prasad will present a number of sessions with Sun Life Financial and Farm Credit Canada throughout Southern Ontario dealing with "Succession Planning for Family Run Businesses"

Stephen Posen and **Stephen Messinger** have been listed as Leading Infrastructure lawyers by Lexpert

Stephen Messinger is the Chairperson for ICSC Canadian Retail Forum Program Planning Committee, November 2012