



Business Law Playbooks

Part 5 – Incorporating a Not-For-Profit (NFP) Corporation

Prepared by the Queen's Business Law Clinic in collaboration with Queen's Partnerships and Innovation

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About Queen's Partnerships and Innovation

Queen's Partnerships and Innovation ("QPI") aims to advance research, innovation, and knowledge mobilization to strengthen Queen's local, national, and global impact. QPI provides faculty, students, post-doctoral fellows, and other members of the Queen's community with a variety of services and resources to facilitate strategic initiatives and research partnerships. QPI is also proud to work with external organizations (both industry and not-for-profits) to connect them with expertise, resources, and incubation support.

About Queen's Business Law Clinic

The Queen's Business Law Clinic ("QBLC") is a free legal clinic which was established in 2009 to provide year-round legal services to a wide variety of individuals, businesses and non-for-profit organizations in southeastern Ontario. The QBLC aims to help individuals and businesses who would otherwise have difficulty affording legal counsel, while providing Queen's Law students with practical legal experience working with clients, while instilling in them the values of community service and the pro bono tradition. The QBLC is proud to have contributed to the economic growth and social well-being of Kingston and its surrounding communities by helping entrepreneurs, small businesses, charities and not-for-profit organizations with their legal needs.

Why do you need a Playbook?

For many people with little or no previous business or entrepreneurial experience, understanding the relationship between law and business – and how it may affect the success or failure of their business idea – is a very important step. In this series of Playbooks, we seek to provide general information on the legal concepts that should be considered by the entrepreneur starting out their business venture.

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5 Incorporating a Not-For-Profit (NFP) Corporation

For the purposes of this Playbook, we will only be discussing NFP corporations. Other forms of corporations will have their own unique features. Please refer to the corresponding Playbook for for-profit corporations and registered charities.

5.1. What is an NFP?

An NFP corporation is a corporation without share capital that carries on activities without net profit. These activities include almost every type of voluntary association, church, trade, professional association, and advocacy organization.

An NFP corporation may not be operated for the gain of its members, directors, or officers. An NFP can raise revenue that produces a profit, but all profits must be used or distributed in furtherance of the NFP's objectives and for the benefit of the NFP. The NFP Corporation can carry on activity so long as it pertains to its objective and is not operated in a net profit situation. These objectives are defined in the incorporation documents, which will be addressed later in this section.

5.2. Is an NFP corporation right for you?

Incorporating an NFP is not the only way to achieve your organization's goals. Instead, a charitable trust or an unincorporated association may also be viable options, depending on your organization's goals. The benefits of incorporating an NFP include a formal management structure, limited liability, and perpetual existence. However, the benefits of incorporation are not free. In exchange, there are formalities that need to be complied with, both in the process of incorporation and in maintaining the NFP. Some of these formalities include maintaining corporate records (such as registers of members, directors, or officers), filing an annual return, reporting any changes to the directors or registered office address, keeping your articles up to date, and sending copies of any new by-laws or changes to your by-laws to Corporations Canada.

5.3. Not for Profits and Charities

Charities are not a distinct business vehicle, but a designation under the *Income Tax Act* (“ITA”). Many charities are NFP corporations and many NFP corporations have the intention of gaining charitable status, but both are distinct designations. In simple terms, NFPs provide to the community as a public benefit, but its focus is not on obtaining donations to support those endeavours. Contrastingly, with a charitable corporation much of the focus is to gain financial donations to support the endeavours. Registered charities must use their resources for charitable activities and have charitable purposes that fall into one or more of the following categories:

- 1) The relief of poverty (e.g. Food bank)
- 2) The advancement of education (e.g. Research institute)
- 3) The advancement of religion (e.g. Missionary organizations)
- 4) Other purposes that benefit the community (e.g. Animal shelter)

NFPs are associations, clubs, or societies that are not charities and are organized and operated exclusively for social welfare, civic improvement, pleasure, recreation, or any other purpose except profit. Examples of NFPs include:

- Amateur sports organizations (e.g. Soccer league)
- Social or recreational groups (e.g. Golf club)
- Certain festival organizations (e.g. Parades)

While NFP corporations enjoy tax exemptions, charities are able to issue donation receipts, which allow for donees of the charity to write off a portion of their taxable income.

5.4. Features of an NFP

Not-for-profit corporations are similar to for-profit corporations in the features they offer. Not-for-profit corporations enjoy the same separate legal personality, perpetual existence, and limited liability benefits.

5.4.1. *Separate Legal Personality*

One of the most important notions of incorporation is that NFP corporations have all the legal rights of a natural person. This means that NFP corporations are free to enter into contracts using their own name, borrow money on their own credit, own their own property, declare bankruptcy, sue, and be sued in their own capacity.



5.4.2. Perpetual Existence

A perpetual existence can be attractive to not-for-profits as the corporation can continue running in perpetuity, as long as it continues meeting its obligations under its governing legislation. Members and directors can come and go, but the property will be retained by the not-for-profit and the operations can continue under new directors.

5.4.3. Limited Liability

Not-for-profit corporations also have the benefit of limited liability, but this benefit is less pronounced than its for-profit counterpart. Members of the corporation are not liable for the defaults and liabilities of the not-for-profit corporation, whether it arises from contracts the corporation enters or the corporation's tortious conduct.

5.5. Structure of an NFP

5.5.1. Articles of Incorporation

The articles of incorporation (the "articles") are created during the incorporation of the NFP Corporation. The articles sets out the name of the not-for-profit, the province or territory the registered office is situated, the size of the board of directors, the statement of the purpose of the corporation, restrictions on the activities the corporation can carry on, classes of members, distribution of property upon liquidation, and any other provisions the incorporators decide on.

5.5.2. Board of Directors

The board of directors is responsible for managing the activities and affairs of the corporation, and have a wide range of powers. Directors decide the actions that the NFP Corporation will take to further the NFP's stated purposes. Directors are legally obligated to act honestly and in good faith in prioritizing the corporation's interests. Directors are required to exercise the care, diligence, and skill that a reasonably prudent person would in comparable circumstances. This means directors cannot do anything that goes against the corporation's articles, by-laws, or a unanimous member agreement. Directors have increased liability compared to members because of their position as the decision-makers in the company.

5.5.3. Members

Instead of shareholders, not-for-profit corporations have members. Classes of members are established in the articles and they oversee and approve certain director decisions. NFP corporations have the option of creating multiple classes with different conditions for each membership class. If you only have one class, all members have the right to vote. If there are multiple classes, at least one class of members must have the right to vote.

In general, members are not liable for any default of the NFP Corporation. However, members may become liable in the same way as a director, if all the members of a corporation sign a document called a "unanimous member agreement". Unanimous member agreements can take power away from directors and assign that power to the members instead. In taking power away from the directors they also assume the risk of liabilities the directors have. In most circumstances, only members in a voting class can influence business decisions by voting to

approve director actions. Examples of business decisions that voting members can affect are changing the by-laws, and electing or removing directors.

5.6. Federally Incorporated NFPs

Similar to for-profit corporations, you may choose to incorporate your NFP Corporation in a federal or provincial jurisdiction. Federally incorporated NFPs will be governed by the *Canada Not-for-profit Corporations Act* (“CNCA”) while Ontario NFPs are governed by the *Ontario Not-for-Profit Corporations Act* (“ONCA”).

There is a fee attached to the federal incorporation process for NFPs when you file online. Federal NFPs can use an automatically assigned number name (e.g. 12345678 CANADA Association) or a worded name of your choosing. Opting to use a worded name instead of a numbered corporation will also require a NUANS name search report, which will require an additional fee.

Advantages of a federally incorporated NFP include turnaround time and Canada-wide name protection. A federal incorporation is completed the next business day, and the name you choose will be yours across Canada. For example, if your NFP plans to organize events, promotions, or establish offices in other provinces, the federal NFP incorporation will provide you with the highest level of name protection and wider rights to carry on business throughout the entire country. Federal incorporation means that you are able to do business across Canada using the same business name, even if some other company is already using a similar name in some province or territory. So, if your federally incorporated business is XYZ Inc., you can do business in any province or territory as XYZ Inc., even if there are other companies operating under identical names in the same provinces or territories. Federal incorporation also has a cachet that provincial incorporation does not and gives a company global recognition.

The disadvantages of a federally incorporated NFP mostly relate to the corporation’s upkeep costs. Like federal for-profit corporations, federally incorporated NFPs need to register in their home province or territory where they carry on their activities.

Registration is different from incorporation. An NFP may incorporate only once, but registration of the federal NFP is required by its home province or territory usually within a few weeks of incorporation. There are no registration fees for home province or territory registration. Federal incorporation also requires more paperwork to be done every year as you will need to comply with corporate filing requirements. Federal NFPs need to file a Corporate Tax Return and Corporate Information Return, in addition to return of all the provinces the NFP is extra-territorially registered with. Federal incorporation may cost more because of the additional annual paperwork required, as well as the additional fees resulting from the need to register your corporation extra-provincially.

5.7. Ontario Incorporated NFPs

Incorporating provincially cannot currently be done online but needs to be applied for in-person or by mail. Just like federal NFPs, there is a cost attached to incorporation and provincial NFPs



can choose to use a numbered or worded name. The provincial name search will cost more than the federal NUANS search.

The upkeep of an Ontario NFP offers a comparative advantage over federal NFPs. The tax and annual filing requirement are done as one, reducing the associated legal and accounting fees.

The incorporation process is the major downside to incorporating provincially. While the incorporation fee is lower for provincial NFP corporations than federal NFP corporations, the wait time is vastly longer. Ontario only allows for NFPs to incorporate by mail or in-person, and takes 6-8 weeks to process (there is an expedited option to get the process completed in 7 business days). Each provincial incorporation is a standalone process. Once incorporated, your NFP's name will only be protected in Ontario. To do business in another province, you will need to register with that authority.

5.8. Soliciting and Non-Soliciting NFPs

Non-profits can be categorized as soliciting or non-soliciting NFPs under the *CNCA* (for provincially incorporated NFPs, they are instead called “public benefit corporations” and “non-public benefit corporations”). Soliciting corporations are those that receive more than \$10,000 in a calendar year from government grants, funds from another corporation that also received funds from public sources, or gifts and donations from non-members. Soliciting corporations have more stringent oversight requirements, to ensure transparency and accountability of public funds. For federally incorporated NFPs, this includes having at least two independent directors who are not officers or employees of the corporation, more stringent financial reviews, restrictions on where the property can be distributed upon the dissolution of the corporation, and a ban on unanimous member agreements. The “soliciting” status will last for three years regardless of whether or not your corporation receives \$10,000 in the two years after receiving the status.

	Soliciting Corporation	Non-soliciting Corporation
<u>Number of directors</u>	Minimum of 3 with at least 2 not being officers or employees	At least 1
<u>Financial review</u>	Under \$50,000 gross annual revenues <ul style="list-style-type: none"> • Default is review engagement*; audit or no review possible Between \$50,000 and \$250,000 gross annual revenues <ul style="list-style-type: none"> • Default is audit**; review engagement possible Over \$250,000 gross annual revenues <ul style="list-style-type: none"> • Must have an audit 	Under \$1 million gross annual revenues <ul style="list-style-type: none"> • Default is review engagement; audit or no review possible Over \$1 million gross annual revenues <ul style="list-style-type: none"> • Must have an audit



<u>Filing financial statements</u>	Yes	No
<u>Restrictions on property upon liquidation</u>	Yes – to qualified donees under the <i>Income Tax Act</i>	No restrictions
<u>Unanimous members agreement</u>	Not allowed	Allowed
<p>* Financial statements prepared by a public accountant who does not express an opinion on the fairness of the financial statements. He/she provides a limited assurance that the financial information is plausible and conforms to IFRS generally accepted accounting principles. ** Financial statements are prepared by the public accountant after examining accounting records and other evidence supporting the financial statements. He/she provides a professional opinion on whether the financial statements present a fair picture of the organization's financial position and its activities during the period the audit covered.</p>		

In Ontario, the categorization of public and non-public benefit corporations also depends on the amount of government funding or external donations received. Both Ontario and Federal NFPs that are receiving public funds will have increasingly more onerous financial reviews when receiving higher levels of public funds. This can result in requiring a full audit. Ontario NFPs are allowed to receive more public money before a full audit is required and allows for an extraordinary resolution (80% of voting members) to waive a review engagement (verifies whether the financial statements are plausible).

5.9. Charitable NFPs

If you plan to have your not-for-profit register as a charity under the *ITA*, there are additional considerations for your incorporation of a not-for-profit. There needs to be an additional restriction on the corporation in that the directors of the not-for-profit corporation cannot be compensated. The corporation must also have charitable purposes of either advancing education, advancing religion, relieving poverty, or have some other purpose that benefits the community.

5.10. Steps to NFP Incorporation

5.10.1. Step 1: Decide Which Legislation to Incorporate Your NFP Under

Before you start the NFP incorporation, you may want to consider whether an NFP corporation is the most appropriate business vehicle for you. Some factors to consider are limited liability, perpetual existence of the corporation, taxation matters, costs of incorporation and maintenance, and whether you want national presence.

Additionally, you should also consider whether you want to be federally or provincially incorporated. Are there any other third-party requirements that may affect your jurisdiction of incorporation or form of vehicle?



5.10.2. Step 2: Consider Your Corporation's Purposes

Your corporate purposes must accurately reflect the nature of your organization and it must be consistent with the intended tax status of the corporation. A NFP's purposes must be for social welfare, civic improvement, pleasure or recreation, or for any other purposes, except profit. For example, an NFP in the photography field might describe its purpose as "the establishment and operation of a photography club for the purposes of studying and promoting the art and science of photography, and such other complementary purposes not inconsistent with these objects".

5.10.3. Step 3: Conduct a Name Search

If you choose to use a unique name of your choice, you must confirm the availability of your desired name through a NUANS name search report (a Federal or Ontario-biased NUANS search, depending on your jurisdiction). When you are deciding on the name of your organization, you may want to consider whether the name reflects the nature of the organization, is easily recognizable, and whether you would want to seek trademark protection.

5.10.4. Step 4: Consider Expected Grant Funding or Donations

If you expect to receive more than \$10,000 grants, funds, or gifts and donations from non-members during a single fiscal year, you may want to structure your organization in anticipation of becoming a soliciting corporation. This includes appointing a minimum of 3 directors and preparing to file financial statements to Corporations Canada.

5.10.5. Step 5: Prepare Incorporation Application

If you choose to incorporate federally, you will need to file two documents, the Articles of Incorporation (Form 4001) and the Initial Registered Office Address and First Board of Directors (Form 4002).

When incorporating provincially, only one form is required, the Application for Incorporation of a Corporation without Share Capital (Form 2).

Both applications will require similar information: The name of the not-for-profit corporation (along with the NUANS search if needed), the head office of the corporation, the initial directors of the corporations, the purpose of the not-for-profit, and the classes of memberships that the corporation can establish.

5.11. Post-Incorporation Matters

After incorporating, there are several post-incorporation steps for the corporation to take. The corporation must draft and maintain its minute book and by-laws. Unlike the articles of incorporation which govern the corporation very generally, by-laws of a corporation dictate how the corporation will manage its affairs internally. The directors need to have a first meeting to ratify the incorporation documents and pass by-laws. The directors can also decide on how corporate records would be maintained, appoint officers, appoint an interim public accountant, authorize the issuance of debt obligations, or make banking arrangements at this first meeting

as well. Lastly, memberships must be issued, a fiscal year end date set, and the first directors appointed.

The members also need to hold their meeting, to confirm (or modify, or reject) the by-laws of the corporation and elect the directors. Provincial and territorial registrations must also be filed in every jurisdiction the business carries on its activities (if needed) along with fulfilling any other requirements such as obtaining permits or satisfying other formalities. For example, you may need a provincial permit to carry on activities in a particular sector, such as a bingo license in order to operate a bingo, or liquor permit in order to sell alcoholic beverages.

5.12. Maintaining a Not-for-Profit

Continuing a NFP corporation requires annual filings. For federal NFPs, this involves an annual return with Corporations Canada as well as a tax filing with the CRA. For provincial NFPs, the annual return with Service Ontario is included with the NFP's tax filings as one document.

Not-for-profits must also conduct regular meetings of both the board of directors and annual general meetings for the members, so directors can be elected, annual financial statements reviewed and certain matters voted on. Ongoing obligations also include keeping a corporate minute book up to date (with the corporation's by-laws) and depending on the amount of contributions from the public, an annual audit or review engagement. Other obligations may include filing a change of registered office address, reporting changes regarding directors, sending copies of changes to by-laws or the addition of new ones, and filing articles of amendments.

5.13. Conclusion

Incorporating a not-for-profit will grant your organization legal status and may be a worthwhile decision if you value the formal management structure, limited liability, and perpetual existence benefits they can bring. These benefits can come at a cost, and require you to undertake several formalities, like maintain corporate records, filing annuals returns, reporting changes to the directors, updating articles, and sending copies of new or changed by-laws to Corporations Canada. Whether the benefits of incorporating outweigh the costs will depend on your personal situation. If you believe you are ready to incorporate your not-for-profit, you may wish to contact the QBLC for assistance.