

REFORM

WORKING PAPER

OCTOBER 2008



LAW OF INCORPORATED ASSOCIATIONS

Québec 

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Reform of the law of incorporated associations
Working Paper

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A word from the Minister

In Québec, associations with a juridical personality, that is to say, incorporated associations, are active in almost all spheres of social life: leisure, sports, culture, child care, domestic help, etc. In doing so, their activities benefit a very large number of citizens, hundreds of thousands of which are members or directors of these associations.

However, it has been considered for a long time now that the legal framework of incorporated associations is obsolete.

In September 2004, the enterprise registrar rendered public a working paper concerning the reform of this area of law.

In May 2005, he posted on the registrar's website the numerous comments received, as well as a summary of them.

In October 2005, the enterprise registrar submitted to the Minister of Finance the results of the consultation. These results are now posted on the website of the *ministère des Finances*.

This working paper concerning the reform of the law of incorporated associations takes into consideration the comments made during the consultation held by the registrar, as well as the results he summarized.

Today, this work allows us to submit to the general public the basis of what could be a new legal framework for incorporated associations.

The proposals outlined in this paper basically aim to meet the needs of associations, their members and directors, while modernizing the framework that is applicable to them.

This is why I am seeking the knowhow and experience of interested persons. Their comments will guide us concerning the validity of these orientations and the adjustments we may make. I thank them in advance.

If these proposals actually do meet the needs of associations and their members, they may be included in a bill tabled in the National Assembly within the coming months.

The Minister of Finance,

Monique Jérôme-Forget

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Introduction

The object of an association is to undertake activities other than making monetary profits to be shared by its members.

Many associations collect donations which are generally earmarked for charitable purposes in various fields.

In Québec, associations are present in various aspects of our lives. In fact, they are an integral part of their community and they often contribute to social development as a complement to public services. Most of them are active at the local or regional level and some of them are active throughout Québec.

In 2004, due to the obsolescence of the law of incorporated organizations, the enterprise registrar published a working paper that unleashed numerous reactions. In fact, during this consultation, more than 400 briefs were submitted. This shows that the interests of associations are important to stakeholders

It is in such a context that the *ministère des Finances* is making new proposals in this working paper. It hopes to have a general consensus on the basis of the comments submitted. The Minister of Finance will then be in a position to table a bill on this matter.

1. STATE OF THE SITUATION

1.1 Obsolescence of the law of incorporated associations

Presently, the legislative framework applicable to most incorporated associations is defined in Part III of the *Companies Act*. More than 52,000 associations are governed by these rules.

Part III dates back to 1920 and has practically not been amended since then. It renders many sections of Part I of the same act applicable to associations, although they mainly apply to business corporations. Several of these sections are also obsolete.

Other public interest legislation also governs associations. Most of such legislation dates back to another age.

In addition, approximately 1,500 private interest bills regarding associations were enacted by the National Assembly of Québec over time. Occasionally, the National Assembly must amend one or other of these acts in connection with strictly private interests, although the National Assembly's main role is to deal with matters of public interest.

While the framework of incorporated associations remained static, other fields of law were subject to revision. Accordingly, more than 25 years ago, the National Assembly enacted Part IA of the *Companies Act*, which updated the provisions governing business corporations at that time. We may also underline the coming into force in 1994 of the *Civil Code of Québec*. This Code maintained the principle of contractual freedom. It involves a series of rules concerning legal persons, as well as associations constituted by contract, which are called contract associations.

In such a context, it is not surprising that most of the participants to the consultation held by the enterprise registrar agreed on the necessity of extensively amending the law of incorporated associations.

On the other hand, on June 13, 2008, the federal government tabled a bill to amend the law governing not-for-profit corporations of federal jurisdiction (Bill C-62).

1.2 Proposals made by the enterprise registrar

The working paper of the enterprise registrar submitted three main orientations, that is to say:

- The establishment of a single framework having a minimum number of rules and giving room to broad freedom of organization;
- The application to associations that do not have by-laws, of a model which would be adopted by a regulation enacted by the government;
- The establishment by an association of a patrimony appropriated to a purpose for the donations or subsidies received for the same purpose and which would be distinct from its own patrimony.

It was also proposed to allow financing by the issue of shares. This proposal was made to specifically cater to the preoccupations of directors of associations in the social economics sector.

1.3 Reactions to the registrar's proposals

Most of the participants in the registrar's consultation expressed their hesitations about the general orientations and certain specific proposals.

As far as donations are concerned, the notion of a patrimony appropriated to a purpose has caused confusion. Several participants considered that this entailed an obligation to constitute a trust rather than the obligation not to combine the property donated with the association's own patrimony.

In addition, most of the participants disagreed with the possibility of financing by the issue of shares.

Participants also mentioned that they wanted a reform of the rules governing associations. However, they did not agree with a unique model having a minimum number of rules. On the contrary, they would like to have a more substantial set of rules. In addition, according to several of them, the proposals did not reflect certain values such as associative democracy.

For more details about these proposals and about the opinions made, see the report drafted by the enterprise registrar entitled *Constats découlant de la consultation sur le document Propositions pour un nouveau droit québécois des associations personnifiées*, [Findings resulting from the paper entitled Proposals for New Québec Legislation for Incorporated Associations], available on the website of the *ministère des Finances* at: www.finances.gouv.qc.ca.

2. PROPOSALS MADE BY THE *MINISTÈRE DES FINANCES*

2.1 Summary

The proposals made by the *ministère des Finances* for the reform of the law of incorporated associations may be summarized as follows:

- Maintain a proven legal structure, that is to say, establish rules concerning the incorporation of an association, its operation and winding up;
- Modernize the law of incorporated associations by establishing a framework which is more complete than what was proposed by the enterprise registrar;
- Grant more powers to the members to make fundamental decisions concerning their own association. Presently, most powers are held by the board of directors, including control over by-laws;
- Not derogate from the fundamental rules of the law applicable to legal persons, which are provided under articles 298 to 333 of the *Civil Code of Québec*;
- Provide for additional rules for associations that collect donations to ensure that such donations will be used for the purposes for which they were made;
- Replace several public interest legislations that provide for the founding of associations.

2.2 Comparison with the proposals made by the enterprise registrar

Several measures for the modernization of the law of legal persons as proposed by the enterprise registrar would be retained:

- Grant full legal capacity to an association;
- Except if it collects donations, allow any association that decides to do so to be managed by one director;
- If he or she is liable to disciplinary measures, specifically provide for the right of a member to make representations;
- Maintain rules that give associations some latitude, such as the possibility of establishing categories of members;
- Allow any contract association to continue its existence as an incorporated association.

Basic measures of protection would be established for the apportioning of donations. Associations would not be required to hold donated property distinctly from that of their own patrimony. Subsidies received from public organizations would not be targeted by these rules.

Financing by the issue of shares is a complex subject which is controversial. Because this concerns only a minority of associations, it will be discussed distinctly from the proposals made in connection with associations in general. Associations and organizations in the field of social economy are specifically invited to make precise proposals on how to settle this issue.

2.3 Specific proposals

2.3.1 Founding an association

In the present system the possibility of founding an association is a privilege granted by the State. It is suggested that this privilege become a right. In doing so, the State would no longer control the objectives of associations.

Because by definition an incorporated association is a group of persons, it would involve at least two members.

The founders would file with the enterprise registrar a declaration of constitution of an association. This declaration would contain the same information as what is presently required in a declaration of registration under the *Act respecting the legal publicity of sole proprietorships, partnerships and legal persons* (Act respecting legal publicity). This declaration would constitute registration. On the other hand, this legislation could be amended to require that the following information be added to the declaration:

- The objective of the association;
- Whether or not it intends on soliciting public donations.

This information should be kept up to date.

If the association infringed its objective by contracting with a third party in good faith, this contract would nevertheless still be valid.

The name of the association should end with the letters I.A., to show its legal structure as an incorporated association.

In many associations, members have equal rights and obligations (egalitarian associations). In other associations, by-laws provide for categories of members. For the purpose of encouraging transparency, egalitarian associations would be allowed to show their difference by using the letters E.I.A. These letters would supply significant information about the nature of the governance of the association: an egalitarian structure.

2.3.2 By-laws and members

The power to adopt and amend by-laws would, as it is now, belong to the board of directors, except for subjects identified as "fundamental" which would be specified by the new structure. Amendments adopted by the board should be approved by the members of the association to remain in force. If an amendment was not approved by the members at the latest at the following annual general meeting, the board would not be subsequently allowed to enact and apply a similar amendment without obtaining approval by the members beforehand. On the other hand, the association would have to supply a copy of its by-laws free of charge to every new member who requests it.

Decision-making powers on fundamental subjects would belong to the members. To come into force, fundamental decisions would have to be made or approved by the members or the members of a certain category specified in the by-laws. The election of directors and any change to the objectives of the association would be part of the fundamental subjects, as the situation is now. New fundamental subjects would concern for example, conditions for the admission of members and their financial obligations.

In principle, associations could determine in their by-laws the percentage of the vote required for approving fundamental decisions. However, the act would require a strong majority vote (for example 2/3) for decisions concerning the following subjects:

- Objective of the association;
- Name of the association;
- Head office of the association;
- Amalgamation;
- Winding up;
- Continuation as another type of legal person.

The association would be allowed to determine in its by-laws, categories of members and to grant different rights to them. This flexibility would allow associations to adjust their internal structures to their specific needs.

In general, members must meet at the same place to make their decisions. It is suggested to let associations have the possibility of determining in their by-laws the means of decision-making which they consider the most appropriate. These means could allow for distance communications and voting. By facilitating the participation of members in this way, it would be possible to reinforce democracy within associations.

Subject to the association's by-laws, it is suggested that no quorum be required for an assembly of members and that a member may not in principle be represented by a proxy. These rules are different than those specified in the *Civil Code*.

Because it is rather frequent that only a minority of members participates in meetings, a quorum corresponding to the majority of members would be quite restrictive. It would therefore be preferable to let every association determine a quorum if it wishes to do so.

On the other hand, a member could be represented by a proxy if the by-laws allowed this.

Finally, it is suggested to require that an association be obliged to mention in the draft agenda for the annual meeting of its members, the proposals or items submitted by the members. At the beginning of the meeting the members would then decide if these proposals or items should be noted on the agenda.

2.3.3 Directors and other officers

Associations would continue to act by its internal structures, that is to say, its board of directors and assembly of members. However, if the by-laws specify that each of the members is also a director, there would be no structure called "assembly of members." This possibility would allow small associations to simplify their administration even more.

In compliance with the principle determined under the *Civil Code*, only physical persons could act as directors of an association.

Up to now an association must be administered by a board of directors on which at least three persons sit. It is suggested that a board of directors may be composed of one or several directors, as in business corporations.

We underline the fact that under the *Civil Code*, directors are considered to be mandataries of the association.

Under the present rules, directors are not liable for the payment of salaries to the employees of an association. Because of the obligation of good faith for directors, and because employees are not aware of the financial situation of the association, directors should have some liability on this point when they are themselves paid for their work.

In addition, a court called on to assess the extent of the liability of an director and to determine damages could accordingly reduce them by considering the following new factors:

- The circumstances in which the director acted;
- The fact that he based his decision on the opinion of an expert chosen in good faith;
- The fact that he is a minor or a protected person of full age.

As far as directors' decisions are concerned, they are generally made at a meeting. Directors travel to meet at the same place. However, they may also participate in a meeting of the board of directors by telephone. Unanimous written resolutions of directors are another means of decision-making.

It is being considered that directors' decisions may be made by any means, unless the by-laws provides for specific ways of proceeding. This proposal also aims to increase flexibility in the administration of the association and to take into consideration new available technologies.

On the other hand, a director who did not participate in decisions made by the board of directors will be deemed to have consented to the decisions made, unless he advises the association of his dissent within a certain time limit. The idea behind this proposal is to prevent directors who neglect to attend meetings from having an advantage as far as liability is concerned, over those who do attend.

As far as bookkeeping is concerned, it could be minimal, unless the association sought and received donations, in which case its bookkeeping should be more detailed.

2.3.4 Transformation, winding up and liquidation

Contrary to the present framework, a contract association would be allowed to continue its existence as an incorporated association.

The present amalgamation process entails the founding of a new association, which integrates the amalgamated associations. In addition, it is suggested to allow an association to integrate another one so that the members of this association would become members of the association that would continue to exist.

As far as the winding up process is concerned, the association that has debts must obtain the consent of its creditors. Its directors become solidarily liable to creditors who had not consented to the winding up.

However, the decision to wind up an association must not depend on creditors. It is suggested that directors be solidarily liable for the obligations of the association only regarding known creditors who were not advised within a specified time limit. In principle, members and directors are not personally liable for an association's debts. However, the right to action an association before a court of law within three years following its winding up should be granted.

As far as the present liquidation process is concerned, in which the liquidation of property precedes the winding up of the association, this should be maintained. It is preferable that directors remain subject to the rules governing mandate which have always been applied to them, rather than the rules of liquidation specified in the *Civil Code* (administration of the property of others).

The property of the liquidated association which was given by third parties should be remitted to another legal person or to a trust having objectives similar to those of the association.

It is presently impossible to apply for the revival of an association that has been voluntarily wound up. Because of the facility in founding another association, it seems appropriate to maintain the status quo.

2.3.5 Additional rules for donations

Some additional rules could be applied to associations receiving public donations to ensure that they are used for the purpose for which they were made. However, these rules would not apply to subsidies granted by public organizations.

Associations would not be required to hold their own patrimony distinctly from that of the funds or other property donated. However, they would be required to maintain detailed accounting showing the source and use of those funds.

A rule would require the association to have at least five members and five directors. However, it would be possible for an association to have three members and three directors if it was founded since less than one year or if it received for the preceding fiscal year, less than \$30,000 in donations. In addition, at least half of the directors should be independent of each other.

No special rules would govern solicitation activities.

It is suggested that the rules concerning donations govern all non-profit legal persons that solicit donations in Québec, whether or not they are associations or founded under Québec legislation. It is also suggested that these rules be applied to contract associations.

The government could by regulation, exempt legal persons or organizations from the application in whole or in part, of these rules. For example, it could examine the possibility of exempting contract associations which receive less than \$1000 in donations per year.

In practice these rules would apply mainly to associations having status as registered charities. These rules would not be a repetition of the tax requirements that apply to them and which mainly concern financial information. We underline the fact that these charities may issue official receipts to their donors, thereby allowing them to reduce their income tax.

Documents and information about these donations would be available to the public, namely the statement of earnings, that is to say, the income and expenditures in the past fiscal year. In fact, it seems to be of general interest that members of the public have a right of inspection of associations that collect donations.

A complaint procedure is being considered to enforce the rules concerning donations. The following is a description:

- A person could make a complaint to an association because it infringed additional rules concerning donations.
- The association would have to answer this complaint within 60 days.
- If the person is not satisfied with the answer or the follow up given to his complaint, it would be able to complain to an authority (organization or person) that or who would be appointed for that purpose by the Minister of Finance.
- If the complaint is well founded, the authority must advise the general public and mention as the case may be, how the association corrected the situation or adopted a compensatory measure.

These proposals are designed to encourage honesty and transparency and accordingly to maintain the credibility of associations in the public eye.

2.4 Replacement of legislation and continuance of associations

2.4.1 Public interest legislation

The new framework could replace Part III of the *Companies Act*, as well as the following legislation:

- *Fish and Game Clubs Act*;
- *Amusement Clubs Act*;
- *An Act respecting societies for the prevention of cruelty to animals*;
- *National Benefit Societies Act*;
- *An Act respecting farmers' and dairymens' associations*;
- *Horticultural Societies Act*.

This legislation, as well as Part III of the *Companies Act* are obsolescent and their replacement does not seem to give rise to any difficulties. The associations in question would be continued as of right under the new framework as of the filing of their annual declaration, in compliance with the Act respecting legal publicity. Such a declaration would ensure the continuance of the association.

This legislation would be replaced as of right at the latest on the expiry of the time limit of two years following the coming into force of the new legislation.

Associations that omitted to file their annual declarations for two consecutive years would be continued as of right under the new framework, on the date on which this legislation would be replaced. However, under the provisions of the Act respecting legal publicity, their registration could be struck.

In practice, associations governed by this special legislation could continue to express their identity due to the publicity in the register of enterprises, indicating their name, their objective and their sector of activity. In other words, the distinctive personality of these associations, which namely resulted from their specific enabling legislation, could still be expressed under the new framework.

2.4.2 Private interest legislation

Approximately 1500 private interest laws govern associations. In general, they provide for the rules of operation which are usually specified in by-laws. Every time an association intends on amending these rules, the National Assembly must enact a bill, in spite of the fact its role is essentially to enact public interest legislation. It would be an advantage for associations, which have to incur expenses and sometimes significant delays, to not have to request amendments to such legislation.

In order to encourage the continuation of these associations within the new framework, it is suggested that such a continuation may be effected without any expense.

Conclusion

The proposals made are in line with the continuity of present law and they involve clear improvements.

These proposals aim to modernize and simplify the law of incorporated associations. They are made for discussion purposes, to allow interested parties to make comments and if appropriate, to submit new proposals.

Any association, organization or person wanting to make comments is not restricted to the content of this working paper.

Comments received for the purpose of this initiative could be made public.

Comments should be preferably forwarded by email by March 31, 2009 at the latest to the following address: dpif@finances.gouv.qc.ca

Or by mail to:

Martin Landry
Directeur du développement du secteur
financier et des personnes morales
Ministère des Finances
8 Cook, 4th Floor
Québec City, Québec G1R 0A4

Telephone: 418 646-7545
Fax: 418 646-5744
email: dpif@finances.gouv.qc.ca

Glossary

Assembly of members

Part of the structure of an association that is made up of all of its members and which may make decisions in the name of the association.

A meeting of the members of an association.

Associative democracy

Democracy in an association.

Board of directors

Part of the structure of an association that is made up of all of its directors and that may make decisions in the name of the association.

A meeting of directors.

By-laws

The rules adopted by a group for its organization and operation.

Document containing these rules.

Contract association

An association founded by contract.

Declaration of registration

A document submitted to the enterprise registrar by a physical person, a group or a legal person for the purpose of its registration in the register of individual enterprises, partnerships and legal persons.

Egalitarian association

An association in which the members have the same rights and obligations.

Incorporated association

An association incorporated as a legal person in compliance with the rules specified by law.

Legal person

A fictional entity that is incorporated pursuant to the formalities specified by law and which, like a physical person, has a legal personality and a patrimony, so that it has rights and obligations.

Patrimony

All rights and obligations of a person or an unincorporated entity, such as a trust, specifically including that person's or the entity's property.

Patrimony appropriated to a purpose

Patrimony or part of a patrimony that is used for a specific purpose.

Patrimony that does not belong to a person or to the State and that is used for a specific purpose, namely a trust.

Private interest legislation

An act that concerns certain special or local interests.

Protected person of full age

A physical person at least 18 years old for whom a court has ordered the institution of protective supervision as a curatorship, a tutorship or has appointed an adviser on the basis of the extent of that person's physical or mental degree of incapacity.

Public interest legislation

An act that is not of private interest, that is to say, which is in the general interest of society.

Quorum

A minimum number of persons who must attend or be represented at a meeting for it to be valid.

Social economy

A sector of the economy that essentially concerns the cooperative movement (cooperatives and financial services cooperatives), insurance organizations of a mutual nature (ex. mutual insurance associations) as well as associations that may be described as enterprises.

Trust

A patrimony appropriated to a purpose which generally results from a contract or a will and by which a person transfers part of his property to a patrimony which that person constitutes for a specific purpose, the property of which is held and administered by a trustee for the purposes of that objective.

