KEEPING CURRENT

Aug 25, 2022

Social Clubs with Share Capital and the Ontario Not-for-Profit Corporations Act, 2010

By Clifford S. Goldfarb

Clifford S. Goldfarb
Counsel
416.865.6616
cgoldfarb@grllp.com

*Social clubs with share capital ("social companies") remain under the Ontario Corporations Act (the "**OCA**") after the Not-for-Profit Corporations Act, 2010 (the "**ONCA**") came into effect on October 19, 2021, but must take steps to be continued under the ONCA, the Ontario Business Corporations Act, or the Co-operative Corporations Act by October 18, 2026 (OCA ss.2 and 2.1). Those that fail to do so will be dissolved.*

Share Capital Social Clubs

Share capital social clubs currently in existence in the province of Ontario are non-profit companies with share capital, most of which were incorporated under Part II of the Ontario *Corporations Act*, RSO 1990, c C.38 ("**OCA**"). Some were incorporated under other acts, but eventually came under the jurisdiction of the OCA due to legislative action. These clubs include golf, tennis and social clubs in which the members, or some of them, hold shares in the company. Many of these clubs have letters patent issued many decades ago. In some cases the original share structures included both common and preferred shares, as well as voting and non-voting shares. Some of these were issued to the club's founders so long ago that it is no longer possible to determine who holds the shares that were originally issued. Often it is these "founders' shares" which have the right to participate in the distribution of the assets of the club when it is wound up. In some cases the shares held by the current members do not have the right to participate beyond their paid-up amount, usually $1.00 per share.

Transition Provisions for Share Capital Social Clubs under the OCA

The OCA contains transitional provisions for these share capital social clubs. In 2010, as part of the process required to facilitate the proclamation of the Ontario *Not-for-Profit Corporations Act, 2010* (the "**ONCA**"), the OCA was amended to provide transitional provisions for "a corporation with share capital that has objects in whole or in part of a social nature", described in the header as "share capital social clubs". The OCA was again amended on November 14, 2017 as part of the process to facilitate proclamation of the ONCA (S.O. 2017,

Continued on page 2

c.20, Sched. 7). Included in these 2017 amendments was a new term, "social company", defined as "a company that has objects in whole or in part of a social nature" (OCA, s.1). A "company" is defined as a corporation with share capital (OCA, s.1). Accordingly, the transitional provisions apply only to social clubs with share capital.

When the ONCA came into effect on October 19, 2021, social clubs without share capital which were incorporated or had been continued under Part III of the OCA were automatically continued under the ONCA without any further action being required on their part. However, the OCA continues to apply to share capital social companies incorporated under the OCA, as well as to those incorporated under a special act of the Ontario legislature, or under any general or special corporate legislation of pre-Confederation Ontario or the former Province of Canada (i.e., the combined former Colonies of Upper Canada and Lower Canada between 1841-1867), with a head office and business activities in Ontario (OCA, s.2.1(a)).

How the OCA applies to social companies after the ONCA came into effect

Social companies will automatically be dissolved five years after the ONCA was proclaimed (October 19, 2026) unless, prior to that date, they have applied to be continued under one of three Ontario statutes:

- the ONCA;
- *Co-operative Corporations Act*; or
- *Business Corporations Act* (the "**OBCA**"), OCA, s.2.1(1).

This Practice Note assumes that a decision will be made for the corporation to continue under the ONCA. Most social companies will likely find it appropriate to continue as non-share corporations under the ONCA, rather than under the OBCA or the *Co-operative Corporations Act*. However, that decision is subject to a number of tax and other considerations, including whether or not to continue as a for-profit or not-for-profit corporation, as well as the current and proposed nature of the rights of the members in the equity of the company.

A corporation is not permitted to continue under ONCA, s.115(2) if it was incorporated under "a predecessor of this Act". However, under ONCA s.1(3) a reference to a predecessor of the ONCA only includes those provisions of the OCA which "applied to a body corporate without share capital." Part II of the OCA is accordingly not a predecessor of the ONCA and social companies may be continued under ONCA, s.115 as a result.

Prior to December 31, 2020 the ONCA contained provisions similar to the CNCA, whereby, on certain fundamental matters, members of each class of voting shareholders were entitled to vote separately as a class. In addition, non-voting shareholders were entitled to voting rights on certain fundamental matters. However, these provisions were not proclaimed in effect and in 2021 all references to them were removed from the ONCA. As a result, companies that continue under the ONCA now have far more flexibility in structuring their membership classes and in determining which have voting rights. This will minimize the amount of revision that might be required in setting up the rights and privileges of membership classes after the continuance.

Consequences of continuance under the ONCA

A social company which has been continued under the ONCA will become a "public benefit corporation" ("PBC") if, during the financial year in which it is continued, it received more than $10,000 in the form of grants or similar financial assistance from the federal government or a provincial or municipal government or an agency of any such government (ONCA, s.1(1)).

The PBC status would commence in the financial year after the year in which test is met (ONCA, s.1(3)). Since "grants or similar financial assistance" has not yet been considered by a court in Canada under the ONCA, or under the *Canada Not-for-Profit Corporations Act,* which has a similar provision, it is likely that a social company which received government assistance of any kind during the COVID-19 pandemic would become a PBC. It is also possible that a social club which benefited from municipal tax concessions or other types of non-direct financial assistance could meet this test. The test is an annual one and a corporation could go back and forth between PBC and non-PBC status annually.

If timing permits, a social company which would not satisfy the test to become a PBC in the year after it did satisfy the test, could delay its ONCA continuance to the second year.

As a PBC, a corporation's accounting requirements could become more onerous. An audit is mandatory if annual revenues exceed $500,000, and an audit or review engagement is mandatory if they exceed $100,000 (ONCA, ss.68 & 76). For non-PBC's these limits are increased to $500,000 for dispensing with an audit or review engagement, and an audit or review engagement only becomes mandatory with revenues of more than $500,000.

Not more than one-third of the directors of a PBC may be employees of the corporation or any of its affiliates (ONCA, s.23(3).

Once a corporation is a PBC it cannot distribute assets to its members on a winding-up. The assets would have to be distributed to another PBC with similar purposes, a registered charity or federal government or a provincial or municipal government or an agency of any such government (ONCA, s.150(1)). This requirement overrides any provision in its articles (ONCA, s.167(5.2)). Even if the corporation does not meet the test to be a PBC in the year of its dissolution, it will still be deemed to be a PBC if it met the test during any of its three immediately prior financial years. It should, however, be possible for the corporation to simply delay its dissolution for three fiscal years after it last met the test to be a PBC. Although a discussion of tax issues is outside the scope of this note, it is likely that the corporation would not qualify as a not-for-profit corporation under the *Income Tax Act (Canada)*, during the year in which it disposed of its property and succeeding years until dissolution.

Shareholder approval required for continuance to ONCA

In order to continue, a social company will have to pass a special resolution, which, under the OCA, is one passed by the board of directors and confirmed, with or without variation, by a two-thirds majority of the votes cast at a duly called special or general meeting of the shareholders, or signed by 100% of the voting shareholders (OCA, s.1(1)).

If a social company has more than one class of shareholders, each class must approve the continuance by a separate special resolution, thereby giving each class a veto (OCA, s.2.1(4)). Unfortunately, the section simply refers to "class of shareholders" and does not make it clear whether non-voting shareholders will be given a vote in this situation. The section of the ONCA which allows non-Ontario corporations to be continued under it refers only to voting shareholders (ONCA, s.115(2)-(3)), but is not applicable to the continuance of social companies. This may become an issue for social companies with a class of non-voting shareholders which have the right to participate in remaining assets on a winding-up. Best practice would be to include the non-voting class in the approval process.

If the company is unable to obtain a quorum for each class of shareholders, it can apply to a court for an order waiving shareholder approval (OCA, s.2.1(7)). The court may make the order if it is satisfied that reasonable efforts have been made to locate shareholders and notify them of the meeting. The order may be subject to appropriate terms and conditions in the circumstances (OCA, ss.2.1(4) and (5)). It is not clear from the wording of s.2.1(8) whether the court may dispose of issues other than the inability to convene a quorum. This procedure will be helpful where the founding shareholders and their heirs no longer have a connection to the company and cannot be found. The steps taken to locate missing shareholders should be documented and included in the court application. Such steps include:

- Newspaper ad or if there are local Facebook pages, etc., postings there.
- Search in local phone directories
- Letter to all members requesting info
- Following up with former lawyers
- Following up with accountants or former accountants
- Interviews with older members, particularly directors – seeking old documents with relevant club history – financial statements, news letters
- Search historical online local newspapers
- Genealogical research if only a small number of shareholders need to be located

Despite any other legislation, no governmental consent will be required for the continuance (OCA, s.2.1(2)).

During the five-year period transition period, or until continuance, a social company may not amend its letters patent under the OCA to bring them into compliance with the act under which it proposes to be continued (OCA, s.2.1(3)). Any such amendments would have to be made as part of the continuance under ONCA, s.115(4).

Consequences of failure to continue
Failure to continue under one of the three acts will result in the company being automatically dissolved one day after the expiry of the five year period (OCA, s.2.1(7)).

Social companies dissolved on this basis will be deemed to continue to exist for the sole purpose of holding a meeting of members to pass a special resolution to continue under one of the three acts, to apply to a court for an order waiving the requirement for a special resolution and to file articles of continuance under one of the three acts (OCA, s.2.1(8)). In that case the social company would be revived on the date a certificate of continuance is issued and is deemed for all purposes to have never been dissolved – subject to any conditions imposed by the Director under the OCA and to the rights of any person acquired during the period of dissolution (OCA, s.2.1(9)). The period of time during which a dissolved social company can apply to continue will expire 20 years after the original five-year period has run (i.e., 25 years after the ONCA comes into effect, October 19, 2046), after which the provisions relating to revival will be repealed (S.O. 2017, c.20, Sched. 7, s.4(2)).

Property of a dissolved company that has not been distributed to the shareholders will be subject to the *Forfeited Corporate Property Act, 2015*, SO 2015, c 38, Sch 7.

Steps to consider in preparing for continuance
Social companies that have not already done so should now begin to prepare for continuance. While they have until October 18, 2026 before being required to continue, there are a number of issues that should be reviewed, and action taken, if necessary, prior to the continuance:

- Institute a process to review the corporate structure, locate missing shareholders and, if possible, eliminate

their right to expropriate the value of the social company's assets on winding-up.

- Social companies which continue under the ONCA are required to eliminate their share capital on continuance (ONCA, s.115(3)(a))[1]. This could result in a windfall for the holders of the equity shares originally issued to capitalize the club, underscoring the necessity of analyzing their existence and development of a plan to minimize their effect. Shares of social companies with par value can most likely be cancelled on payment of the par value established by the letters patent, by-laws or other corporate instruments which created the shares and established their conditions.

- It is also possible for a social company to continue under the federal *Canada Not-for-profit Corporations Act* S.C. 2009, c.23, s.211. The process is similar to that which applies to continuance under the ONCA.

How to continue under the ONCA

- Pass special resolution of shareholders – each class must vote separately
- Prepare articles of continuance – see Form Articles of Continuance

- Draft ONCA by-law for approval by the shareholders at the time of approval of the continuance
- Pay out par value of shares to be cancelled, or make provision for determining the value of shares that are entitled to share in the equity of the company on dissolution
- Discuss conversion of rights of shareholders to rights of members. If these were different before, consider combining shareholders rights with Class A or senior members' rights, etc.

Contact us

If you have a Non-Profit and Charities matter and are in need of legal advice, please do not hesitate to contact Clifford S. Goldfarb, at 416.865.6616 or cgoldfarb@grllp.com.

1 If the shareholder's location is not known, which will frequently be the case, provision can be made in the corporation's accounts for a reserve to be carried forward for a reasonable time after continuance. However, in the case of no-par value shares which are entitled to participate ratably in the remaining assets on winding-up (which are known to exist in a number of clubs), it will most likely be necessary to value these shares based on the current value of the assets of the corporation. Clubs which own significant real property are very valuable and the per share calculation of this value could be a significant problem. Even if the valuation takes into account that there is no intention of the current members to dissolve, an appropriate discount rate to determine the present value of shares may be difficult to fix. One possible solution is to amend the OCA to provide that, despite an equity component in these shares, the cancellation amount is to be fixed at the amount originally paid up for them on the books of the corporation.