

Donor-Restricted Charitable Gifts: A Practical Overview Revisited II*

TERRANCE S. CARTER

*Carter & Associates, Barristers and Solicitors, Orangeville, Ontario***

Part II

[Editor's Note: The paper on which this article was based was intended for a legal audience but the issues surrounding donor-restricted charitable gifts must be of some concern to all executives and boards who accept such gifts on behalf of the charitable organizations they serve. So that readers may benefit from access to the full text of Terrance Carter's comprehensive survey of the topic, this article appears in two parts. Part I can be found in Vol. 18, No. 1; Part II appears below.]

5. What Are the General Forms of Donor-Restricted Charitable Gifts? (continued)

(B) Donor-Advised Funds and Precatory Trusts

(1) What Is the Nature of Donor-Advised Funds and Precatory Trusts?

The basic characteristic of donor-advised funds and precatory trusts, in contrast to other forms of donor-restricted charitable gifts such as special purpose charitable trusts or conditional gifts, is that they do not have any enforceable restrictions associated with them. With both donor-advised funds and precatory trust funds, the donor expresses a preference, desire or request that something be done with the gift, but such expressions are made as a "suggested direction", not as a legal obligation upon the charity. This notwithstanding, there is

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**Carter & Associates is affiliated with Fasken, Martineau, Dumoulin LLP, Barristers and Solicitors. Terrance Carter serves as counsel to Fasken, Martineau, Dumoulin LLP on charitable matters.

normally considerable moral obligation placed upon a charity receiving such a form of gift.

(2) What Is a Precatory Trust (Designated Gift)?

In *Christian Brothers Gen. Div.*, Blair J.⁷⁰ stated that a precatory trust was not a trust at all but only a nonbinding request of the donor. For ease of reference, the relevant quotation from the decision dealing with precatory trusts is repeated here:

A “precatory trust” is not a trust at all. Where the donor gives or bequeaths the property to the charitable corporation absolutely and merely imposes some sort of a moral obligation on the corporation to use the property in a certain way – using words of expectation or desire or purpose, but not words indicating that the donee is not to take the property beneficially but only for the objects or purposes described – no charitable purpose trust is established. The charitable corporation takes the gift or bequest and holds it – and any property derived from it – for the general charitable purposes and objects of the corporation.⁷¹

Since a precatory trust is a misleading term in that it is not in fact a trust, it is more useful to describe such a gift as an unrestricted gift that is accompanied by a nonbinding designation. For ease of reference, such gifts may be referred to simply as “designated gifts”. Designated gifts are often encountered by religious charities where donors wish to support a specific missionary who is employed by a missionary organization. In Interpretation Bulletin IT-110R3, CCRA permits a donor to make a gift subject to a general designation or direction, i.e., requiring that a gift be used in a particular program operated by the charity, provided that the decisions regarding the use of the donation within the program rest with the board of the charity. As a result, the designation by a donor that a gift is to be used to support missionaries in general would be acceptable to CCRA but the further designation that the gift *must* be used to support a particular missionary would not be acceptable to CCRA, or binding on the charity.

A donor could, however, indicate as a nonbinding designation accompanying the gift that, where possible, the donation be used to support a particular missionary. Such a form of designation would constitute a designated gift or precatory trust because it would not be binding on the charity.

(3) What Are Donor-Advised Funds?

A donor-advised fund is a form of designated giving whereby the donor makes a gift to a charity and then periodically makes nonbinding recommendations as to the distribution of assets from the fund to other charities or for certain charitable activities. Donor-advised funds are widely used in the United States where they are referred to as “advise-and-consult funds”, “donor-designated funds”, “donor-directed funds”, “gift funds”, “advisory funds”, or simply “accounts” or “funds” within community trusts or foundations.⁷² The difference between a donor-advised fund and a designated gift or precatory trust is that

with designated gifts, the donor's intentions, although not binding, are stated only once at the time that the gift is made, whereas with donor-advised funds, the donor has input into the distribution of the funds on a continuing basis.

The primary concern with donor-advised funds is that if too much control is retained by the donor, it will no longer be considered a gift at law and cannot be receipted under the *Income Tax Act*. As a result, charities that employ donor-advised funds must be careful to warn donors that input by the donor can be of an advisory nature only. The documentation creating a donor-advised fund must clearly state that it is the charity that administers the fund, reserving the right not to follow the donor's suggestions or advice concerning the distribution or application of them. (A more thorough discussion of the income tax consequences involved in donor-advised funds will be found later in this article.)

The advantage of donor-advised funds is that such funds allow the donor to receive an immediate tax deduction for a charitable gift while deferring the ultimate disbursement of the gift for future charitable projects. It is similar to having an informal private foundation within the parameters of an established and well-organized charity that has the benefit of proper administration and guidance from the charity's board of directors. Given the restrictions that are being encountered with regard to gifts to private foundations as a result of the 1998 amendments to the *Income Tax Act*,⁷³ the option of using donor-advised funds may become more attractive for many charities and foundations, particularly for community foundations.

(C) Conditional Gifts

(1) What Is the Nature of a Conditional Gift?

The distinction between a conditional gift and a special purpose charitable trust is not easy to make, particularly since a conditional gift can also be a special purpose charitable trust. Part of the distinction relates to the ownership of the gift and the other part relates to the wording accompanying the gift. A conditional gift involves the charity becoming the beneficial owner of the gift, either after the condition has been fulfilled or until a condition subsequent fails or occurs, as the case may be. With a special purpose charitable trust on the other hand, the charity never becomes the beneficial owner of the gift. Instead, the charity holds title to the gift in trust, subject to certain terms and restrictions. It is possible for a conditional gift to also be a special purpose charitable trust if the gift involves both a condition and a donor requirement that the gift be used for a particular purpose. For example, the donor might say, "I give \$1,000,000 as a perpetual endowment for cancer research, on the condition that the charity opens a cancer research facility in Calgary by the year 2010".

With a conditional gift, the operative wording involves a transfer of beneficial ownership of the gift, subject to an independent clause of defeasance commencing with words such as "but if", "provided that", or "on condition that". It is

not sufficient, however, to look only at a particular phrase or word to determine if a gift is conditional; it is important to look at the whole wording of the document by which the gift is given.⁷⁴

A condition which is repugnant to the nature of the gift granted, such as a condition that totally restrains the alienation of the gift by requiring, for instance, that rents of the property never be raised, will be void. Similarly, an illegal condition, such as a condition requiring a breach of the law or a discriminatory action, will also be void.⁷⁵

The general rule that a charitable purpose is exempt from the rule against remoteness of vesting, i.e., the “modern rule against perpetuity,” does not apply to a conditional gift:

In general, if a gift to a charity or charitable purpose trust is conditional, in unreformed jurisdictions, the rule applies to require that the gift necessarily vest within the perpetuity; in reformed jurisdictions [i.e., in Ontario], we ask whether it must so vest, and if not, we wait and see whether in fact it does so vest.⁷⁶

(2) What Is a Condition Precedent?

A condition attached to a gift will be a condition precedent when the condition must be fulfilled before the gift takes effect.⁷⁷ In this sense, a condition precedent is properly construed as a condition of acquisition. A condition precedent may be an express instruction, for example, that a testamentary gift of \$100,000 to be used for a pediatric ward of a hospital on the condition that the board of the hospital commences construction of the pediatric ward by a specific date. A condition precedent may also be implied, as is often the case with a matching gift, e.g., a gift of \$100,000, provided that the charity is able to raise an equal amount of money within a stated period of time.

If the condition precedent is not fulfilled within the specified time period, the gift fails to take effect. A conditional gift will also fail if the condition precedent violates the rule against perpetuity in accordance with the applicable “wait and see” principle in reformed jurisdictions like Ontario.⁷⁸

In the event that a condition precedent fails, the transfer of the beneficial ownership of the gift to the charity will not occur and ownership of the gift will remain with the donor. Since a gift subject to a condition precedent is not a gift at law until after the condition is fulfilled, it would be improper for a charity to issue a charitable receipt for income tax purposes for the gift before the condition precedent had been fulfilled.

(3) What Is a Condition Subsequent?

A condition subsequent is a condition which operates to bring to a close or defeat a gift which has already taken effect, i.e., the condition subsequent will divest a gift that is already complete.⁷⁹ In this sense, a condition subsequent is properly construed as a condition of divestiture. Examples of charitable gifts subject to a condition subsequent include a gift to a charity on the condition that

it care for impoverished children from a particular church parish and a gift of a building on the condition that it be used to operate a church of a particular denomination.⁸⁰

If the condition subsequent fails and the gift contains a right of reversion back to the donor, the reversion to the donor will be operative only if the failure of the condition occurred within the relevant perpetuity period and if the gift did not contain a gift over to another charity. On the other hand, if there is neither a reversionary right in favour of the donor or a gift over, the failure of the condition subsequent will leave the initial interest of the charity as an absolute interest that is no longer subject to any conditions or other donor restrictions.⁸¹

If a condition subsequent fails and the gift reverts to the donor, the donor will have received a double benefit: an initial charitable receipt from the charity at the time the gift was made, coupled with the return of the gift or as much of it as remains. To avoid a double benefit in such a situation, it would be incumbent upon the charity to advise CCRA that the original gift is being returned to the donor in accordance with the failure of a condition subsequent so that CCRA can ensure that the returned gift is reported as taxable income by the donor.

Since a condition subsequent may result in a subsequent tax liability if the original gift is returned, it would be prudent for the charity to recommend that the donor intending to give a gift which is subject to a condition subsequent obtain independent legal advice before making the gift to ensure that the potential tax implications of the gift have been fully evaluated. At the same time, the board of a charity will obviously have to determine whether it is prudent for the charity to accept a gift subject to a condition subsequent, since the gift may eventually have to be returned to the donor. If the charity accepts a gift subject to a condition subsequent, it will have to hold the capital or property as a donor-restricted charitable gift in a designated trust account and reflect it as such in its financial statement. This is in recognition of the fact that the gift may eventually have to be paid back to the donor or, if there is a gift-over designated by the donor, to another charity.

(D) Determinable Gifts

A technical variation on a gift that is subject to a condition subsequent is a determinable gift. The distinction between a condition subsequent and a determinable gift is a fine point of law. With a condition subsequent, the gift is absolute, but is subject to being defeated if the condition is not fulfilled. With a determinable gift, the gift consists of a limited interest which will eventually come to an end, e.g., “I give the income from my commercial building so long as I own the building and the charity uses the property income to run a youth centre”. In this regard, a determinable interest “bears a seed of its own destruction and is said to determine automatically, whereas a conditional interest is complete but with an independent clause added which may operate to defeat it.”⁸²

The language used is a helpful indicator — although not a perfect one — to identify whether a gift is a determinable gift or a gift subject to a condition subsequent. Certain words like “while,” “during,” “so long as,” or “until” are generally identified with a determinable interest, whereas terms such as “on condition that,” “provided that” and “but if” will normally trigger a condition subsequent. An example of a gift that the courts in England have interpreted to be a determinable gift is a gift to a church so long as the minister teaches a particular doctrine.⁸³

When a determinable gift comes to an end, the capital will normally revert to the donor unless there is a gift over to another charity. As with a gift subject to a condition subsequent which is fulfilled, the charity should advise CCRA of the taxable benefit to the donor where a determinable gift comes to an end and some or all of the original capital is returned to the donor.

(E) Gifts Subject to Donor Directions Under the Charities Accounting Act

As indicated earlier, if the more formal approach to establishing a special purpose charitable trust articulated by Blair J. in *Christian Brothers Gen. Div.* prevails over the more traditional approach of Levine J. in *Christian Brothers B.C.S.C.* in considering all relevant circumstances to determine the donor’s intent, then there may be fewer enforceable special purpose charitable trusts than many charities and donors have assumed. However, even if this were to occur, charities and their boards of directors would be acting at their peril if they decided that they could ignore the wishes of the donor if circumstances warranted it. This is because s.4(d) of the *Charities Accounting Act* of Ontario provides a mechanism by which the Public Guardian and Trustee of Ontario can seek a court order requiring a charity to comply with the directions of a donor.

The relevant portions of s.4 of the *Charities Accounting Act* are:

Sec.4 If any such executor or trustee,...

- (c) has made any improper or unauthorized investment of any money forming part of the proceeds of any such property or fund: or
- (d) *is not applying any property, fund or money in the manner directed by the will or instrument,*
...a judge of the Ontario Court (General Division) upon the application of the Public Trustee, may make an order,...
- (f) requiring the executor or trustee to pay into court any funds in the executor’s or trustee’s hands and to assign and transfer to the Accountant of the Ontario Court, or to a new trustee appointed under clause (g), any property or securities in the hands or under the control of the executor or trustee;
- (g) removing such executor or trustee and appointing some other person to act in the executor’s or trustee’s stead;

- (h) directing the issue of an attachment against the executor or trustee to the amount of any property or funds as to which the executor or trustee is in default;...
- (j) *giving such directions as to the future investment, disposition and application of any such property, funds or money as the judge considers just and best calculated to carry out the intentions of the testator or donor;*
- (k) imposing a penalty by way of fine or imprisonment not exceeding twelve months upon the executor or trustee for any such default or misconduct or for disobedience to any order made under this section;... [emphasis added]

The effect of s.4(d) of the *Charities Accounting Act* means that the Public Guardian and Trustee of Ontario can seek a court order to enforce a direction imposed by a donor without being required to establish that a special purpose charitable trust had been created. All that is required is that a “direction” by the donor be shown. This is a much lower threshold for either a disgruntled donor or the Public Guardian and Trustee of Ontario to meet but still achieves the same result – as if a special purpose charitable trust had been created by the donor and had been breached by the charity. In either situation, a court would be able to order the charity to comply with the terms of the direction established by the donor.

Ironically, if the violation was categorized by the courts as being a violation of s.4(d) of the *Charities Accounting Act*, then, in addition to the directors of a charity being found in breach of trust, the directors could also be exposed to a court imposed penalty and even face imprisonment in accordance with the provisions of s.4(k) of that *Act*.

(F) Ten-Year Gifts Under the Income Tax Act

Another form of donor-restricted charitable gift involves gifts that qualify for an exemption from the 80 per cent disbursement quota imposed upon registered charities under the *Income Tax Act*. Subsection 149.1(1) of the *Income Tax Act* requires that a registered charity must expend 80 per cent of its received income from the previous taxation year, subject to certain exemptions, one of which is gifts subject to a restriction that the property of the gift or property substituted therefore, cannot be expended for a period of at least 10 years. The key elements of what constitutes a 10-year gift under the *Income Tax Act* are that it must be a gift:

- received subject to a trust or direction; and
- that it be held for a period of not less than 10 years.

The specific wording of ss.149.1(1) is:

“...disbursement quota” for a taxation year of a charitable foundation [also a charitable organization] means the amount [which is] 80 per cent of the total of all amounts each of which is the amount of gift for which the foundation [charitable organization] issued a receipt described in subsection 110.1(2) or 118.1(2) in its immediately preceding taxation year, *other than*;

- (b) *a gift received subject to a trust or direction to the effect that property given, or property substituted therefor, is to be held by the foundation for a period of not less than ten years...* [emphasis added]

A more complete discussion of the income tax consequences involving 10-year gifts is included later in this article. What is germane at this point is that a 10-year gift can be established by means of either a “trust” or a “direction”. This means that the issues involving what constitutes a special purpose charitable trust would apply to 10-year gifts that are created by means of a trust. Similarly, the issues involving gifts subject to a direction under the *Charities Accounting Act* would apply to 10-year gifts that are created by a direction as opposed to a trust.

In this regard, if the wording of a gift or the surrounding circumstances are not sufficient to establish the gift as a special purpose charitable trust, but instead only constitute a direction, then even though the expenditure of capital before 10 years might not constitute a breach of trust in violation of a special purpose charitable trust, it would, as indicated above, allow the Public Guardian and Trustee of Ontario to apply for a court order to force the charity to comply with the terms of the direction to hold the capital for at least 10 years.

What should also be noted concerning 10-year gifts is that, while there is a minimum number of years that the capital of a 10-year gift must be held, there is no limitation on the length of time that the capital *can* be held. As such, an endowment fund where the capital is to be held in perpetuity not only constitutes a special purpose charitable trust but would also constitute a 10-year gift under the *Income Tax Act* for taxation purposes.

6. What Happens When There Is a Failure of a Donor Restriction?

(A) General Comments

Donor-restricted charitable gifts will fail when either a restricted term in a special purpose charitable trust becomes impossible or impractical, a condition precedent or subsequent is unfulfilled, or a limited interest in a determinable gift comes to an end. Depending upon the nature of the donor-restricted charitable gift, different consequences will ensue, bringing with them the option of different levels of court involvement in dealing with the failure of the restrictions.

(B) Failure of a Conditional Gift

As indicated above, when a gift that is given to a charity is subject to a condition precedent and the condition is unfulfilled, then the gift fails to take effect but, when a gift subject to a condition subsequent is given to a charity and the condition is unfulfilled, the gift will revert to the donor (subject to the possibility that the donor included a gift over to another charity which was to take effect if the condition failed).

Where the donor has clearly stated that the gift is to fail if the condition is unfulfilled, it will not be possible, on the failure of the condition, to use the general scheme-making power of the court, such as a *cy-près* application, as *cy-près* applications are only available for unconditional gifts. These would include absolute gifts which were never subject to conditions, as well as those gifts that were subject to a condition of acquisition, i.e., a condition precedent, which has been fulfilled.⁸⁴

The general inability of the court to intervene and extend the donor's initial charitable intent is a major drawback in having donors use conditional gifts. It is therefore important for a charity that accepts or encourages conditional gifts to ensure that the donor is aware of the general inability of the court to grant relief if a failure of the condition occurs, as well as the importance of including a gift-over to another charity in that eventuality.

(C) General Liberal Court Interpretation

Other than a failure of a donor restriction involving a condition precedent or a condition subsequent (which does not occur often), the general rule is that where a gift to a charity would otherwise fail due to vagueness, impossibility, impracticality or general uncertainty, the court is able to exercise an inherent jurisdiction to interpret the gift in a liberal and lenient manner. In *Weir v. Crum-Brown*,⁸⁵ the Court held that "there is no better rule than that a benignant construction will be placed upon charitable bequests".

In its *Report on the Law of Charities*,⁸⁶ the Ontario Law Reform Commission explained that the courts have exercised a liberal interpretation in a variety of cases, including where donors have stated their intentions ambiguously by incorrectly naming or misdescribing a recipient charity⁸⁷ or overlooking the fact that a named recipient charity had been amalgamated with another charity between the time that the will was drafted and the time of the donor's death.⁸⁸ In these cases, the courts have taken a generous view of the donors' words to "look for the true intention and, where possible, salvage the gift."⁸⁹

(D) Failure of a Special Purpose Charitable Trust

(1) Nature of Failure and Court Intervention

A special purpose charitable trust will fail where the donor's restriction is either impossible or impractical to comply with or where the means of carrying out the special purpose charitable trust can no longer be realistically accomplished. In those situations, the charity must seek the assistance of the court in exercising its general scheme-making power through either a *cy-près* court application or the imposition of an administrative scheme (both of which are discussed in more detail below).⁹⁰

(2) Can a Donor-Restricted Charitable Gift be Unilaterally Varied?

Notwithstanding well-established law to the contrary, the boards of many charities believe that a charity somehow has an inherent right to unilaterally

vary the terms of a donor restriction or to interpret liberally what the applicable restriction means. Alternatively, many charities that receive a testamentary gift that is subject to restrictions believe that the executor of the estate also has an inherent ability to unilaterally vary or interpret liberally the donor's restrictions. Neither of these assumptions, is correct. Only the courts can vary the terms of a restricted special purpose charitable trust based upon the court's inherent scheme-making power:

It is not for the directors or trustees of a charity to deal with the funds on their own authority, even with the direction or approval of the original donor.⁹¹

This means that to vary a donor-restricted charitable gift, an application must be made for a *cy-près* order. Any unilateral attempt to vary a donor-restricted charitable gift based only upon the consent of the donor, with the charity acting on its own without first obtaining the necessary court approval, would likely constitute a breach of trust and must therefore be carefully avoided notwithstanding the time and expense of making the necessary court application.

There are two situations, however, in which court approval to vary a donor-restricted charitable gift may not be necessary. The first situation is where a *cy-près* court application is not successful and the gift reverts to the donor in circumstances where there is no gift-over to another charity. The second situation results in the same effect, but is due to the failure of either a condition precedent or a condition subsequent where there is a reversion to the donor. In both situations, the donor would be able unilaterally to reissue the gift to the intended charity once the gift had been received back and at that point either new donor restrictions could be established or the gift could be reissued without any restrictions being imposed.

(3) Cy-près Scheme-Making Power

What is a Cy-Près Scheme?

Cy-près is a shortened form of the phrase "*cy-près comme possible*", which, in Norman French, means "as near as possible."⁹²

The *cy-près* doctrine is generally stated as follows:

If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.⁹³

When Will a Cy-Près Scheme Be Available?

Whether the court will be able to exercise a *cy-près* scheme will depend upon whether the failure is an initial failure or a subsequent failure. With an initial failure, the court will be able to intervene and apply the charitable property *cy-près* only if it can find a general charitable intention of the donor. This

becomes particularly difficult in relation to public fundraising campaigns. If a surplus results from a public fundraising campaign for a particular charitable purpose and the charity is unable to use the monies for its publicly stated purpose, the court will be able to apply the remaining surplus to another charitable purpose only if it can find that the donors, many of whom may be anonymous, had a general charitable intention and did not limit their gifts to the specific project to which the fundraising campaign was directed. The primary problem involved with public surpluses resulting from public fundraising campaigns is therefore determining whether or not a general charitable intent can be found.⁹⁴

To avoid the complexities and costs of making a *cy-près* court application and the possibility that the court may not find a general charitable intention in relation to a surplus in a public fundraising campaign, a charity should clearly state that any surpluses resulting from a fundraising campaign for a particular project will be used to further the general charitable purposes of the charity.

In the event of a subsequent failure of a special purpose charitable trust, the court will apply the *cy-près* doctrine where it can be shown that there is a supervening impracticality or impossibility, without finding a general charitable intent. This is, of course, subject to the requirement that the gift not contain a provision for a gift-over by the donor.⁹⁵

Some examples of both initial and subsequent failures which can result in the application of the *cy-près* doctrine involving special purpose charitable trusts are:

- insufficiency of subject matter, i.e., where the amount of the gift is too small to accomplish the intended purpose;⁹⁶
- where there is no suitable site available to carry out a designated building program;
- the gift is made to a nonexistent charity;
- the gift is made to a misdescribed charity;
- the gift is made to a charity which has ceased to operate;
- the gift is made to a charity which has amalgamated with another charity, unless the letters patent of the amalgamated charity specify how the funds from the predecessor charity are to be applied;
- the gift is made to a charity which has changed its charitable objects between the time that the will was made and the testator's death;
- the trust property is unsuitable for the designated charitable purpose;
- the gift is surplus to the needs of the designated charitable purpose;
- the gift is refused by the charity;
- the charity is dissolved; or

- there is a surplus of capital or income remaining after the charitable purpose has been carried out.

When Will a Cy-près Scheme Not Be Available?

There are a number of situations in which a *cy-près* scheme will not be available to assist a charity upon a failure of a donor-restricted charitable gift:

- *Conditional gifts:* A *cy-près* scheme will not be available if the gift fails because a condition precedent or a condition subsequent has not been fulfilled.
- *Lack of an impracticality or impossibility:* A *cy-près* scheme will not be available unless the court is satisfied that the restrictions in question are either impractical or impossible to be carried out.
- *Legislative intervention:* The ability of the court to apply a *cy-près* scheme is subject to the overriding right of the legislature to impose by legislation whatever terms and conditions it considers appropriate in relation to a particular charitable purpose.⁹⁷
- *Capital endowments:* A capital endowment involving a capital amount that is held in trust by the charity with only the income being available for a particular purpose, such as a scholarship fund, cannot be made the subject of a *cy-près* application. The primary reason is that the charity is holding the property in trust and has only a beneficial interest in the income from the endowment fund.⁹⁸ Even if the charity were considered to have title to the capital (which it does not), the present scope of what the courts regard as an impossibility or impracticality does not encompass a situation where the charity is seeking to apply the capital in a different or more effective application.⁹⁹

The other reason why a *cy-près* scheme is not available for a capital endowment fund is that the donor has clearly indicated an intention that the capital not be disbursed but instead be held in perpetuity. As such, the indefinite duration of a capital endowment fund takes precedence over the cause of advancing a charity effectively.¹⁰⁰

(4) Administrative Scheme Making Power

Closely related to a *cy-près* power, the court may also exercise a scheme-making power where adherence to the administrative terms of a trust would disrupt the specific purpose of the charitable trust.

The normal situation where the court will permit deviation from administrative terms is where a change in circumstances makes adherence to the original administrative terms impossible or impractical. A recent application of the administrative scheme-making power of the court involved the Barnes Foundation in Pennsylvania where the donor, Dr. Albert Barnes, included in the declaration of trust creating the foundation, provisions which severely limited the investment policy of the foundation's endowment funds and strictly forbade charging entrance fees to his Impressionist painting collection, the construction

of new buildings for the collection, and the sale or loan of any of the paintings under any circumstances short of physical deterioration. Due to the inability of the trustees to administer effectively and protect the paintings, the court allowed a variation of the administrative terms of trust to permit the collection of entrance fees and the loaning of pictures to other museums, so that sufficient money could be earned properly to care for and maintain the collection.¹⁰¹

It is interesting to contrast the negative reaction in the United States to a relatively minor variation in the administrative terms of trust involving the Barnes Foundation with the Canadian public's general lack of concern about the wholesale imposition of different charitable purposes involving the McMichael Collection in Ontario.¹⁰² Canadians as a whole appear to be much more comfortable with the authority of both the legislature and the courts to interfere in special purpose charitable trusts. However, it is interesting to note that although the Government of Ontario was successful in dismissing the legal action commenced by the McMichaels alleging breach of contract, the Government of Ontario on its own decided later to reinstate the original terms of the gift from the McMichaels pursuant to an act entitled the *McMichael Canadian Art Collection Act 2000*.¹⁰³

7. What Are the Duties Associated With Donor-Restricted Charitable Gifts?

(A) Nature of the Duties

The duties of directors or trustees of a charity are generally similar to those of ordinary trustees. The difference flows from the fact that, in the case of an ordinary trust, there are beneficiaries to enforce those duties, while in the case of a charitable trust, there is a charitable purpose to be complied with instead of beneficiaries to be accountable to. What follows is a brief explanation of some of the duties of directors and trustees of a charity as they relate to the protection and management of special purpose charitable trust funds and property.

(B) Duty to Comply With Donor Restrictions

The main duty of directors or trustees of a charity is to carry out the charitable purpose of a charity in accordance with the charitable objects set out in the constating documents in relation to unrestricted charitable property and in accordance with the applicable restrictions to special purpose charitable trust funds.¹⁰⁴

Examples of situations where the courts have found that a breach of trust by directors or trustees has occurred for failure to observe the terms of a special purpose charitable trust are summarized below as follows:¹⁰⁵

- A charity diverting a fund intended for one charitable program for use in another charitable program. For example, a charity using monies from

an estate that was intended by the testator to help the poor in one parish by diverting those monies to help the poor in another parish.

- A charity withholding a fund and not having it applied to the purpose for which it was intended by the donor.
- The trustees of a charity concealing the existence of a charitable trust fund by not communicating its existence to the persons or groups intended to benefit from it.
- A charity placing funds into a perpetual endowment fund when all of the funds were intended by the donor to be expended in the short term in support of a particular operational program of the charity.
- A charity mixing its funds with another charity and then applying the combined funds for the purposes of the other charity.
- A charity encroaching upon the capital of an endowment fund that was intended by the donor to be held in perpetuity.
- A church that had received land in trust to further a particular doctrinal statement subsequently using the land for the benefit of individuals adhering to a different doctrinal statement.
- The members of a church unilaterally attempting to alter the terms of a trust deed for church property without first obtaining court authorization.
- A charity borrowing monies from a donor-restricted charitable trust fund notwithstanding that there was a bona fide intent to repay those monies together with interest.
- A charity using surplus funds from a public fundraising appeal for different charitable purposes from those communicated in the public appeal without first obtaining court authorization.
- The directors of a charity altering the terms of a donor's restriction without first obtaining court authorization.

(C) *Duty to Invest*

The directors or trustees of a charity have a duty to ensure that donor-restricted charitable gifts which need not be immediately expended are properly invested. In the event that the terms of a donor-restricted gift are silent about investment powers, the investment powers contained in the constating documents for the charity or, alternatively, those contained in the *Trustee Act*¹⁰⁶ will apply.

Alternatively, if the document by which the donor-restricted charitable gift is created sets out a specific investment power, it is the duty of the directors or trustees of the charity to ensure that the gift is invested in accordance with that power, as opposed to relying on the general investment powers of the charity set out in its constating documents. Failure to do so would constitute a breach of trust and would expose the directors to personal liability for any loss suffered from the investment in question.¹⁰⁷

(D) Duty to Protect and Conserve Trust Property

Directors or trustees of a charity are under the usual duty to protect and conserve the trust property under their administration. Since this includes a duty to ensure that charitable trust property is not improperly alienated,¹⁰⁸ it is incumbent upon directors or trustees to determine what legal steps must be taken when a special purpose charitable trust is being transferred to another charity. In some situations, this may require a consent order under s.13 of the *Charities Accounting Act*,¹⁰⁹ to authorize a change in trustees in accordance with the authority given to the court under s.14 of the *Trustee Act*, as well as a deed of trust to document a change of trustees under s.3 of the *Trustee Act*.

Part of the duty of directors or trustees of a charity to protect special purpose charitable trust funds is to protect those funds from seizure by creditors of the charity. As a result of the decision by Feldman J.A. in *Christian Brothers Ont. C.A.* that the property of special purpose charitable trusts is exigible to claims by tort creditors in the same manner as the general corporate property of a charity, it is incumbent upon directors or trustees of a charity and their legal counsel to take steps to determine what, if any, measures can be taken to insulate and protect special purpose charitable trusts from seizure by tort creditors of the charity. A more detailed discussion of this issue is included later in this article.

(E) Duty to Apply For a Scheme

If the directors or trustees of a charity determine that the charitable purposes or restrictions of a special purpose charitable trust cannot be effectively accomplished without departing from the terms of trust, they are under a duty to secure its effective use by seeking a court order to impose either a *cy-près* or administrative scheme to accomplish the charitable purposes or effectively comply with the applicable restrictions.¹¹⁰

(F) Duty to Keep Accounts

All directors or trustees of a charity are under an obligation to keep proper books of accounts with respect to the affairs of the charity, including donor-restricted charitable trust funds.¹¹¹ In relation to special purpose charitable trust funds, the board of a charity is obligated to track those funds by segregated trust fund accounting and to report those funds separately on its financial statements. Pending the adoption of regulations made pursuant to s.5.1 of the *Charities Accounting Act*,¹¹² each special purpose trust fund is technically to be kept in a separate trust account, i.e., a separate bank account, instead of being pooled together with other trust funds, although very few charities actually comply with this common law requirement.

8. What Are the Legal Consequences of Failing to Comply With Donor Restrictions?

In situations where there is a failure to comply with a donor restriction, an issue that should be raised but often is not, is the legal consequences that may flow from such a failure, whether the restriction be in the form of a special purpose charitable trust, a conditional gift, or a gift subject to a direction. The following is provided as an overview of the issues on this topic.

(A) Consequences Under Common Law

(1) Personal Liability for Breach of Trust

If a donor restriction is in the form of a special purpose charitable trust and the charity fails to comply with its terms, then all of the directors or trustees of the charity would be in breach of trust and would be jointly and severally liable for the full amount of any loss suffered by the charity as a result of the failure to comply with the terms of trust.¹¹³ What the directors or trustees of a charity often do not understand is that joint and several liability means that each member of the board of directors or trustees will be personally responsible and liable for the full amount of the loss, although the trustees or board members who are required to pay for the loss personally could look for indemnification from the other board members or trustees.

(2) Liability for Ultra Vires or Unauthorized Charitable Purposes

In the event that the failure to comply with the donor restriction involves applying the gift for a purpose that is outside of the authorized corporate objects of a charitable corporation, then the board members of the charity could be held personally liable on a joint and several basis for any resulting loss by virtue of having directly or indirectly approved an unauthorized activity of the charity outside of its corporate powers.

(3) Liability for Accrued Interest

In the event that the failure to comply with a donor restriction involves a breach of a special purpose charitable trust, then the charity and its directors would be responsible not only for repaying the principal amount of the misdirected funds but also for paying the interest that would have accrued on the amount of the principal from the date of the breach of trust up to the time that responsibility is assigned.¹¹⁴

(4) Liability for Third Party Claims by Donors and Residual Beneficiaries

One of the legal consequences that could result from a breach of trust involving a special purpose charitable trust is the possibility of civil action by donors for the return of donated property. There could also be civil action by third party residual beneficiaries of a testamentary restricted gift based upon a claim that the testamentary charitable purpose trust was no longer being complied with or, alternatively, was impossible or impractical to comply with. If the court was not able to exercise its *cy-près* scheme-making power to vary the terms of

the testamentary charitable purpose trust, then the gift would revert to the estate, entitling the residual beneficiaries to the capital of the restricted gift together with accrued interest from the date of death.

(B) Consequences Under Statute Law

(1) The Charities Accounting Act

The *Charities Accounting Act of Ontario* contains a number of statutory remedies in the event that a charity fails to comply with a donor-restricted gift. These consequences are discussed in more detail later in this article but have been summarized for ease of reference as follows:

- Section 3 allows the Public Guardian and Trustee of Ontario to require a charity to submit its accounts for formal passing before a judge.
- Section 4(d) permits the Public Guardian and Trustee to obtain a court order to enforce directions established by a donor in making a charitable gift.
- Section 6(1) permits any member of the public to make a complaint in writing to a judge of the Ontario Court (General Division) which, in turn, could result in a court order that the Public Guardian and Trustee conduct a public inquiry under the *Public Inquiries Act*.¹¹⁵
- Section 10 permits two or more people alleging a breach of trust involving a charitable purpose trust to seek such an order as the court “deems in the circumstances to be just”, including requiring an investigation by the Public Guardian and Trustee.

(2) Income Tax Act

In the event that there were repeated failures to comply with donor directions, particularly as they relate to 10-year gifts under ss.149.1(1) of the *Income Tax Act*, it is possible that the charitable status of the charity as a registered charity under the *Income Tax Act* could be put in jeopardy.

(C) Consequences Under Criminal Law

Although rarely a concern, in the event that the directors of a charity failed to comply with donor restrictions and did so with an intent to defraud, then the directors would be exposed to a charge under s.336 of the *Criminal Code*.¹¹⁶ The applicable wording is as follows:

Sec.336 – everyone who, being a trustee of anything for the use or benefit, whether in whole or in part, of another person or for a public or *charitable purpose, converts with intent to defraud and in contravention of its trust, that thing or any part of it through use that is not authorized by the trust is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years. [emphasis added]*

The two key elements of the offence for criminal breach of trust are the following:

There must be a “conversion” of charitable property by a trustee in contravention of the trust for a use that is not authorized by that trust; and the misapplication of charitable property must be done with an “intent to defraud...”.

(D) What Should Be Done If a Failure To Comply With Donor Restrictions Is Found?

In the event that a failure to comply with a donor restriction is found, it would be prudent for the charity and its board of directors to adopt one or more of the following steps:

- Legal counsel for the charity should be retained to provide a legal opinion concerning whether the restriction constitutes a special purpose charitable trust. If not, then it is unlikely that there would be a breach of trust. However, there may still be liability exposure as a result of the charity failing to comply with the “direction” by a donor contrary to s.4(d) of the *Charities Accounting Act*.
- If the gift involves a special purpose charitable trust and a breach of trust of its terms has occurred, then all board members of the charity should be informed in recognition of the fact that all directors would be jointly and severally liable for any loss that may result.
- If donor-restricted charitable funds have been misdirected, misapplied or depleted, those funds must be replaced as soon as possible, together with accrued interest.
- If a loss has occurred that cannot be replenished, consideration should be given to obtaining a consent order under s.13 of the *Charities Accounting Act* pursuant to the court’s authority to provide relief against a technical breach of trust under s.35 of the *Trustee Act*. (Note that the Government of Ontario has excluded the availability of the relieving provision of s.35 for a technical breach of trust involving investments as a result of the recent amendments to the *Trustee Act* in Bill 25.)¹¹⁷
- When donor-restricted charitable funds can no longer be used for their intended purpose, either because it would be impractical or impossible, the board should seek to have the fund applied *cy-près* by obtaining a consent order, if possible, under s.13 of the *Charities Accounting Act*.¹¹⁸
- If the donor-restricted funds have been depleted and board members face the possibility of joint and several liability to replenish the depleted funds, notification should be given to all former members who were on the board at the time of the initial misapplication of the donor-restricted funds or who were on the board at any subsequent time during which the funds continued to be misapplied.
- Where board members are facing potential personal liability, legal counsel for the charity should advise each member of the board to obtain independent legal advice since the solicitor for the charity would be in a

conflict of interest in advising board members concerning their personal exposure to liability and what steps they may need to take.

9. Selected Tax Considerations Involving Donor-Restricted Charitable Gifts

Although it is beyond the scope of this article to provide a detailed or thorough discussion of the tax considerations involving donor-restricted charitable gifts, it is important to note some of the more important income tax considerations affecting donor-restricted charitable gifts. What follows is intended to be a brief overview of selected tax considerations in this regard.

(A) 10-Year Gifts

(1) Defining and Documenting 10-Year Gifts

As indicated earlier, the purpose of a 10-year gift is to provide an exemption from the 80 per cent disbursement quota under the *Income Tax Act* for gifts to a registered charity that are held for a period of at least 10 years. To determine what constitutes a 10-year gift and what is required to document it properly, it is necessary to review carefully the definition of a 10-year gift under the *Income Tax Act*. For ease of reference, the relevant provisions of ss.149.1(1) of the *Income Tax Act* are set out below:

“disbursement quota” for a taxation year of a charitable foundation [also charitable organization] means the amount [which is] 80 per cent of the total of all amounts each of which is the amount of gift for which the foundation [charitable organization] issued a receipt described in subsection 110.1(2) or 118.1(2) in its immediately preceding taxation year, *other than*; ...

(b) *a gift received subject to a trust or direction to the effect that property given, or property substituted therefor, is to be held by the foundation for a period of not less than ten years...* [emphasis added]

The reference to ss.110.1(2) and 118.1(2) above means that the ability to accept a 10-year gift only applies to gifts where a receipt is issued by the charity to either an individual or a corporation. The 10-year gift exception would not exempt a gift made from one charity to another charity. Such exemption, however, would be available by designating the gift as a “specified gift” under ss.149.1(1) of the *Income Tax Act*.

The key elements of a 10-year gift under the *Income Tax Act* require that there must be a gift that is;

- received subject to a trust or direction; and
- held for a period of not less than 10 years.

The fact that a 10-year gift can include a donor-directed gift as well as a donor-restricted charitable trust means that many restricted gifts that do not meet the requirements to create a special purpose charitable trust may still

constitute 10-year gifts where the requirements to document a 10-year gift under the *Income Tax Act* have been met.

The documentation required as evidence of a 10-year gift must include the following:

- the document must be executed by the donor for each gift that is made;
- the document must clearly identify the donee charity, including its official name and registration number;
- the document must indicate the amount of the gift;
- the document must set out the date the gift is made;
- the document must set out the name and address of the donor; and
- the document must set out the serial number of the official receipt issued to the donor for the gift.¹¹⁹

The document should then be attached to the charity's duplicate copy of the receipt and retained with its other books and records.

The requirement that the 10-year gift must be by a trust or direction that is "executed by the donor" poses a practical problem where there is a public fundraising event, such as a dinner or auction, where the net proceeds from the event are added to the endowment fund or other type of 10-year gift. It is not realistic to expect that each person attending the dinner would be prepared to sign a direction or declaration of trust. However, possibly the promotion materials for the event could set out the terms required to establish a 10-year gift under the *Income Tax Act* along with a reply card used to buy tickets that includes a statement that the completion and signing of the reply card is deemed to be the execution of a 10-year gift document. Since this is the author's suggestion only, it would be prudent to first obtain the approval of CCRA before adopting this practice.

(2) *Expenditure of Income*

A primary factor to remember when dealing with the expenditure of income from 10-year gifts is that the 4.5 per cent disbursement quota imposed on private and public foundations each year also applies to a 10-year gift. In this regard, unless the foundation has other monies that it can expend to meet the 4.5 per cent disbursement quota calculated on 10-year gifts that it holds, it is essential that the document creating the 10-year gift permit the expenditure of income earned on the 10-year gift during the 10 years and that the income earned each year is at least 4.5 per cent of the original amount of the gift and any resulting capital gains.

In a situation where there was insufficient income earned to meet the 4.5 per cent quota, the definition of a 10-year gift under ss.149.1(1) would not permit a partial disbursement of any of the capital to meet the 4.5 per cent disbursement quota. The capital must remain intact, even if the 4.5 per cent disburse-

ment quota cannot be met. In a situation where insufficient income is earned on a 10-year gift, a foundation would be put in the impossible situation of either being unable to meet the 4.5 per cent disbursement quota or, if it did try to meet it by disbursing a portion of the original gift or any resulting capital gains, then such disbursement would prove to be futile, since the amount of the gift or any resulting capital gain expended would be added onto the disbursement quota for the charity for that year. This result is further discussed below.

As a result, before a foundation accepts a 10-year gift, it is essential for the board of directors of the foundation to be satisfied that a 4.5 per cent income return on the 10-year gift or overall investment portfolio of the foundation is achievable. If this is not the case, or if the board of the foundation is expecting to be able to expend a portion of the capital of the 10-year gift to meet the 4.5 per cent disbursement quota, then it should not agree to accept a 10-year gift, notwithstanding that the terms of the 10-year gift may contemplate that a portion of the gift or resulting capital gain can be expended to meet the 4.5 per cent disbursement quota. The only alternative would be to apply, under subsection 149.1(5) of the *Income Tax Act*, to have the 4.5 per cent disbursement quota reduced in a particular taxation year in order to advance expenditure of the capital of the 10-year gift.

However, there still remains the question whether the document creating the 10-year gift can authorize the expenditure of any resulting capital gain from the gift by defining “income” earned on the 10-year gift that can be expended to include resulting capital gains. In this regard, Carl Juneau, Director of Policy and Communications for the Charities’ Directorate of CCRA, has stated that capital gains earned from a gift will be considered to be a portion of the “*property given, or property substituted therefor*” under ss.149.1(1) of the *Income Tax Act* and that therefore, no capital gain earned on the 10-year gift can be disbursed during these 10 years. This position was set out in a letter from Carl Juneau addressed to the author and dated September 21, 2000. This is an excerpt:¹²⁰

... Our view is that gains accrued to a property subject to a 10-year trust, or property substituted therefor, cannot be distributed without removing the original gift from the exemption to the disbursement quota. If a charitable foundation were to attempt such a distribution, it would appear to be contravening the terms of the trust or direction, as well as the *Income Tax Act*.

Gifts subject to a trust or direction that they be held for a period of not less than ten years, or property substituted for them, are excluded from the 80% disbursement quota requirement. As you know, charitable foundations typically use such endowments as vehicles for the cumulation of capital to support their long-term charitable activities. Although the terms of a trust may theoretically provide for the exclusion of gain from the 10-year holding period, our view is that in most cases, any gain realized from the original property would be subject to the same 10-year holding period under the statute. Were the foundation to somehow extract

and distribute gains realized from the property, it would be contravening the Act by distributing a portion of the property gift.

It is possible for the terms of a trust or direction to permit donated property to be substituted; in other words, to give discretion to the trustees to change the form of the property such that the trust need only hold property possessing value equivalent to the original gift. However, it does not appear that realized gains could be severed from donated property for distribution in this matter because case law would suggest that a “substitute property” is the total proceeds of disposition of the property for which it is substituted. In other words, notwithstanding the terms of the trust or direction, a distribution of any portion of the proceeds realized on the substitution of a donated property is, for tax purposes, equivalent to a partial distribution of the gift.

As a result, it is important for charities that currently have 10-year gift documentation which permits the disbursement of resulting capital gains, not to exercise that option. Otherwise, the charity would be in violation of the definition of a 10-year gift under ss.149.1(1) of the *Income Tax Act*.

(3) *Consequences of Expending Capital Prior To the Expiry of 10 Years*

In the event that the capital of a 10-year gift, i.e., “property given, or property substituted therefor” under ss.149.1(1) of the *Income Tax Act*, including any resulting capital gains (referred to as “Capital”), is expended within the mandatory 10-year minimum period, there are certain consequences that would result:

- Since the trust or donor direction creating the 10-year gift would require that the capital be held for at least 10 years, then the expenditure of any portion of the capital would constitute a breach of trust where the 10-year gift was created by a trust, or would be a violation of a direction if the gift was created by a donor direction. With regard to the latter, s.4(d) of the *Charities Accounting Act* would allow the Public Guardian and Trustee of Ontario to seek a court order to force the charity and its directors to comply with the donor’s direction.
- The portion of the capital expended prior to 10 years would be added to the disbursement quota of the charity for the year in which the capital was expended in accordance with the definition of the “disbursement quota” under ss.149.1(1) of the *Income Tax Act*. This, in effect, would mean that the amount of the capital expended would be added to, and disbursed, as part of the disbursement quota in the same year, resulting in a neutral impact upon the disbursement quota of the charity for that year. However, as indicated above, this would not assist in meeting a shortfall in the 4.5 per cent disbursement quota for a 10-year gift of a foundation.
- The more difficult question is whether the full amount of the 10-year gift collapses where only a portion of the capital is expended in any one year. This would not appear to be the case in accordance with the wording of ss.149.1(1), in that the amount that is added to the disbursement quota is

based upon the actual amount that is expended in a particular year. As such, if only 10 per cent of a 10-year gift were disbursed in a year prior to the expiry of the 10 years, it would appear that only the 10 per cent actually expended would be added to the disbursement quota, as opposed to including the full amount of the original 10-year gift.

- Based upon the above, some charities have considered gradually disbursing a 10-year gift over a number of years assuming that in doing so there would be no negative impact on its disbursement quota each year. However, a gradual disbursement of a 10-year gift might be seen by CCRA as an intentional misuse of the 10-year gift. This in turn might result in either deregistration of the charity or, alternatively, disallowance of the 10-year gift in the original year in which it was claimed for the full amount of the gift that had been exempted. This is an issue that needs to be canvassed further with CCRA.

(4) Expenditure of 10-Year Gifts After Expiry of 10 Years

The 10-year gift exemption requires only that the trust or direction creating the 10-year gift specify that the capital is to be held for a period of “*not less than ten years*”. This means that a gift which is subject to a trust or direction that it be held for a longer period of time, including a trust or direction that the capital be held in perpetuity as an endowment, would also qualify as a 10-year gift.

It would therefore be open to a donor to create a 10-year gift that specified the donor’s directions concerning the expenditure of the gift after the minimum 10-year period. Failure of the donor or his or her legal counsel to articulate the donor’s directions in this regard would mean that the charity would be at liberty to use the 10-year gift or income in any manner that the charity wanted to, in accordance with its charitable objects, once the 10 years had expired, even if that were not the intention of the donor.

On the other hand, just because a gift is categorized as a 10-year gift in the charity’s T3010 Annual Charity Information Return does not necessarily mean that the capital of the 10-year gift can be expended after 10 years. That issue is determined by the wording of the document creating the 10-year gift. As such, it is important for a charity and its board of directors to ensure that the wording creating a 10-year gift is carefully reviewed to determine if there are any restrictions that continue after the expiry of the 10-year minimum period, such as a restriction that the capital be held as an endowment fund in perpetuity.

(5) Transfer of 10-Year Gifts

It would be reasonable to assume that the transfer of a 10-year gift from one registered charity to another registered charity should have a neutral impact upon the disbursement quota of both charities. However, as a result of what appears to be a drafting error in the wording of paragraph A.1 of subsection 149.1(1) of the *Income Tax Act* in failing to accommodate the designation of a 10-year gift as a specified gift, the transfer of a 10-year gift from a registered

charity to a foundation will result in either the 10-year gift being included in the disbursement quota of the transferee foundation or, alternatively, being included in the disbursement quota of the transferor charity with no offsetting disbursement being available to match the increase in the disbursement quota of the transferor charity. Normally, in order for a transferee foundation to exclude the receipt of a 10-year gift from the calculation of its disbursement quota, the transferor charity would need to designate the gift as a specified gift pursuant to subsection 149.1(1) of the *Income Tax Act*. (Specified gifts are gifts given from one charity to another charity that are designated as such in the transferor charity's information return for the year in which the gift is made so that the disbursement quota of the transferee charity is not increased and, similarly, the transfer does not count in meeting the disbursement quota of the transferor charity.)

However, because of the wording of paragraph A.1 of subsection 149.1(1) of the *Income Tax Act* that defines what a disbursement quota is, the transferor charity cannot record the 10-year gift as a specified gift, since to do so would preclude the transferor charity recording the 10-year gift as a disbursement to offset the inclusion of the transfer of the 10-year gift in the disbursement quota of the transferor charity. What subparagraph (a) of paragraph A.1 of subsection 149.1(1) should have stated is that the inclusion of a 10-year gift in the disbursement quota of the transferor charity specifically excludes a 10-year gift when designated as a specified gift.

As a result of this drafting error (which, it is to be hoped, will be corrected soon), a charity that is intending to transfer a 10-year gift to a foundation will need to either apply for a reduction in its disbursement quota in accordance with subsection 149.1(5) of the *Income Tax Act* by the amount of the 10-year gift being transferred and designate the gift as a specified gift in order to avoid the gift being included in the disbursement quota of the transferee foundation or, alternatively, the transferor charity would need to elect not to designate the 10-year gift being transferred as a specified gift but, instead, have the transferee charity apply for a reduction in its disbursement quota pursuant to subsection 149.1(5) of the *Income Tax Act* for the amount of the 10-year gift. Either of these alternatives is unnecessarily awkward, but until the *Income Tax Act* is amended to correct the apparent drafting error, the alternatives described above appear to be the only practical avenues open to a charity in order to effect a transfer of a 10-year gift in favour of a foundation.

(6) Managing 10-Year Gifts

Although many charities customarily co-mingle their various restricted funds in one single account for investment purposes, and even though such practice may be permitted under regulations of the *Charities Accounting Act*, it would be prudent for a charity to maintain each 10-year gift in a separate account. Although administratively awkward, this approach would avoid potential problems with 10-year gifts, including the following:

- Since the capital (as defined earlier) of a 10-year gift cannot be expended for a minimum of 10 years, and since CCRA takes the position that any capital gains accruing on the original gift or “*property substituted therefor*” are part of the original property that must be held for 10 years, it is essential that the charity be able to clearly identify what the original property of the 10-year gift was, what property was substituted for it, and what capital gains have accrued on the said property. This can be best facilitated by tracking each 10-year gift in a separate account.
- Maintaining a separate account for each 10-year gift would help to ensure that the expenditure of capital during the mandatory minimum 10-year period did not occur in an attempt to meet the 4.5 per cent disbursement quota required from foundations.
- Since each 10-year gift may be subject to different terms and conditions imposed by the donor, i.e., the length of time that the gift is to be held or what investment powers are to apply, the utilization of separate accounts for each 10-year gift would help track when the capital can be expended in accordance with the specific terms of the trust or donor direction and what type of investments the said capital can be put into without breaching the investment powers provided for in the document creating the 10-year gift that may be different from the investment powers of the charity itself.

(B) Conditional Gifts

As indicated earlier in this article, the transfer of title of a gift subject to a condition precedent does not occur until after the condition precedent is met. As such, the charity cannot issue a tax receipt until after the condition precedent is fulfilled and the transfer of the gift is complete.

There is more of a problem when a gift is subject to a condition subsequent. If a charity has issued a tax receipt for a gift subject to a condition subsequent and there is a subsequent reversion of the gift to the donor, it would be important for the charity to advise CCRA so that it can ensure that the donor reported as income the amount of the receipted gift in the year in which the reversion of the gift occurred.

CCRA may go further and take the position that a gift subject to a condition subsequent which includes a reversion of the gift to the donor does not entitle the charity to issue a tax receipt in the first place because there was never an absolute transfer of title of the gift to the charity. Thus, when a charity is presented with a gift subject to a condition subsequent, it would be important to obtain an opinion from CCRA to determine whether or not a charitable receipt can be issued for the gift in the circumstances. It may be that if the wording of the condition subsequent results in the gift becoming vested in another charity, CCRA may view it as a valid gift at law since no portion of the gift could revert to the donor. However, because of the uncertainty on this

issue, it would be prudent to first obtain an opinion from CCRA before the charity issues a tax receipt to the donor involving any type of gift involving a condition subsequent.

(C) When Will Excessive Donor Control Defeat a Gift?

The focus of this article has been to identify, categorize and comment upon the various means by which donors can exercise control over charitable gifts. Implicit in this discussion is the presumption that the gift being given is a gift at law for which a charitable tax receipt can be issued to the donor.

However, there is an important *caveat* to this presumption. If there is too much control exercised by a donor over a gift, then such excessive control may preclude there being a gift at law. This issue is very much a grey area under the *Income Tax Act* since there is nothing specifically included in the legislation, or any publications by CCRA, about when too much donor control will defeat a gift.

In the extreme situation of a donor reserving absolute control over the management, investment and disbursement of a gift, it would not be difficult to conclude that a gift had never been made in the first place and therefore no charitable receipt could be issued. As the amount of control exercised by the donor diminishes, the likelihood of the gift being defeated because of excessive control by the donor also diminishes. To determine where the dividing line is on this issue, it is necessary to review what constitutes a gift at law. In this regard, *Waters* summarizes the common law concerning when a gift will have been made as follows:

For a valid gift *inter vivos* the donor must intend to give immediately, and there must be a delivery.¹²¹ ...

The donor must have absolutely parted with his own interests in the property and have effectively put such interest beyond his own.¹²²

The requirement that the donor must “*absolutely part with his own interests*” would generally mean that the donor’s reservation of a right to control the management, investment or disbursement of a gift may constitute the donor maintaining a type of “interest” in the donated property. Whether or not donor-advised funds, as discussed earlier, particularly those that are administered by community foundations, may directly or indirectly involve excessive control by the donor very much depends upon the circumstances. As such, it would be prudent for a charity that encourages the gifting of donor-restricted gifts, including donor-advised funds, to carefully review the documentation by which the gift is given, as well as the circumstances under which the gift is obtained from the donor, to determine whether or not the amount of control being exercised by the donor is such that it constitutes the reservation by the donor of a material interest in the gift that would preclude there being a gift at law.

Some examples of instances where the amount of control being retained by a donor may be excessive and may necessitate an opinion from CCRA before a charitable receipt is issued would include the following:

- A donor-advised fund where the promotional materials for the fund or other verbal statements about the fund give the impression that the donor's direction concerning the disbursement of the fund will be followed by the charity.
- A donor retaining the right to direct how the gift is to be invested.
- A donor requiring that the gift must be invested in only one type of investment, thereby precluding the board of directors of a charity from being able to exercise its fiduciary obligation to invest the gift prudently as a charitable fund.
- A donor reserving the right to approve recipients of a scholarship or those individuals who can qualify for a scholarship.
- The donor reserving the right to appoint or nominate persons to the board of directors of the charity, or requiring that the approval of the donor first be obtained before a person can be nominated to the board.
- The donor reserving the right to approve or remove a CEO or other senior management of the charity, or imposing a condition that the CEO or other senior management must be either retained or removed.

Since there is little guidance available from CCRA on this issue, it is helpful to refer to the United States to see how the issue has been dealt with in that jurisdiction. In this regard, the courts in the United States have determined that a charitable gift is not made unless and until:

1. The donor has relinquished title, dominion and control of the subject matter of his or her gift;
2. [the donor] has delivered the gift to the donee organization; and
3. the donee has accepted it.¹²³

The matter of excess donor control is an issue under the U.S. *Internal Revenue Code* in determining whether a donor-advised fund established by a donor will be treated as a component of a community trust with entitlement to more favourable tax treatment for the donor, or will be treated as a private trust with less favourable tax treatment. For a donor-advised fund to be considered a component part of a community trust under the U.S. *Internal Revenue Code*, the fund:

1. must be created by a gift, bequest, legacy, devise, or other transfer to a community trust that has established itself as a single entity; and
2. may not be directly subjected by the donor/transferor to any material restrictions or conditions within the meaning of Regulation 1.507- 2(a)(8) of the Internal Revenue Code.¹²⁴

The prohibition against “*material restrictions*” referred to above was imposed to prevent a donor from so encumbering or restricting a donor-advised fund that the community foundation would not be able to freely distribute the donated assets and income from it in furtherance of its charitable purpose.¹²⁵

In accordance with the applicable Regulations under the *Internal Revenue Code*, the determination of whether particular restrictions or conditions placed by a donor on a gift are “*material*” must be determined from a review of all of the facts and circumstances involving the gift. Under Reg. 1.507-2(a)(8)(i), some of the more significant facts and circumstances that would need to be considered in making such a determination are:

- whether the community foundation is the owner in fee of the assets received;
- whether the assets are to be held and administered by the community foundation in a manner consistent with its exempt purposes;
- whether the governing body of the foundation has the ultimate authority and control over the assets and the income derived from them; and
- whether, and to what extent, the governing body of the foundation is organized and operated in a manner so as to be independent from the donor.¹²⁶

In addition to these criteria, the Regulations provide that a “*material restriction*” may exist even if the documentation creating the gift does not explicitly state that the donor has reserved the right to direct future distribution of income or capital. Reg. 1.507-2(a)(8)(iv)(A)(2) states that the Internal Revenue Service will carefully scrutinize situations where there is an indirect reservation of a right to direct a distribution by a recipient foundation after a gift has been made. The reservation of such a right will be considered to exist where the only criteria considered by the foundation in making the distribution of income or capital from a donor’s fund is advice offered by the donor. This is determined by looking at the applicable circumstances, including the presence of some or all of the following factors:

- the community foundation’s solicitations (written or oral) state or imply that the donor’s advice will be followed, or the donor’s pattern of conduct creates such an expectation;
- the advice of a donor is limited to distributions of amounts from his or her fund, and the community foundation has not 1) made an independent investigation to evaluate whether the donor’s advice is consistent with charitable needs most deserving of support by the foundation or 2) promulgated guidelines enumerating specific charitable needs that it will serve (or, if such guidelines exist, they are inconsistent with the donor’s advice);

- the community foundation solicits only the donor’s advice as to distributions from the donor’s fund and no procedure is provided for considering advice from other persons; or
- the community foundation follows the advice of all donors concerning their donations substantially all of the time.¹²⁷

If the above Regulations were in effect in Canada, many donor-advised funds in this jurisdiction would have difficulty meeting these requirements. Nevertheless, although the Regulations do not have application in Canada, it would be prudent for charities that encourage the gifting of donor-advised funds to review the U.S. Regulations concerning what constitutes an acceptable level of donor control in structuring a donor-advised-fund program that could withstand the scrutiny of CCRA if necessary.

As the issue of excessive donor control will probably become a matter of greater regulation by CCRA, it would be worthwhile for charities to take preventive steps now to ensure that donor-restricted gifts do not result in donors retaining too much control over their gifts. Some considerations include the following:

- Although use restrictions, time restrictions or program restrictions will not likely be challenged by CCRA, restrictions which allow the donor to dictate how a gift is to be managed or invested after it has been received by a charity could be perceived as permitting a donor to retain an inappropriate level of “control and dominion”.
- Where there are restrictions over the administration, investment or distribution of a fund, it is essential that the restrictions do not, either directly or indirectly, prevent the charity and its board of directors from freely employing the gift or the income derived therefrom in furtherance of the charitable purposes of the charity.
- In circumstances where the extent of donor control might be questioned by CCRA in the future, it would be prudent that the donor be encouraged to retain independent legal counsel to advise on the possibility of a reassessment by CCRA on the issue of whether the donation was a gift at law for which a charitable receipt could be issued.

(D) Donor Restrictions That Benefit the Donor

Fundamental to an understanding of the tax consequences involving donor-restricted charitable gifts is a recognition of what a “gift” is at law. It is worth repeating the definition of a “gift” from *Black’s Law Dictionary*:

Gift – a voluntary transfer of property to another made gratuitously and without considerations.¹²⁸

Paragraph 3(d) of Interpretation Bulletin 110R3 setting out the requirements for a gift, emphasizes that there can be no benefit received by the donor in making a gift:

3. A gift, for purposes of sections 110.1 and 118.1, is a voluntary transfer of property without valuable consideration. Generally a gift is made if all three of the conditions listed below are satisfied:
 - (a) Some property – usually cash – is transferred by a donor to a registered charity;
 - (b) The transfer is voluntary; and
 - (c) The transfer is made without expectation of return. *No benefit of any kind may be provided to the donor or to anyone designated by the donor, except where the benefit is of a nominal value.* [emphasis added]

In practice, the most common type of donor benefit occurs where the donor's name is recognized in some way by the charity. This normally involves the donor's name being shown in conjunction with some aspect of the charity's operation, such as naming a scholarship fund, a memorial fund, or naming a part of a building. Such a benefit will not normally be considered to be of a material nature that would otherwise preclude a gift from being a gift at law for which a charitable receipt could not be issued.

On the other hand, if the name recognition either directly or indirectly provides a commercial benefit to the donor, i.e., by naming the building of a charity after the name of a business donor or prominently displaying the name of the business with that of the charity in advertising,¹²⁹ then such payment will likely be perceived as a type of "sponsorship" arrangement for which a charitable receipt cannot be issued. However, a business donor would be able to write the payment off as a business expense in lieu of being able to claim a tax credit for a charitable receipt that normally would be received from the charity and, as such, the benefit to the donor business would be the same. G.S.T., though, would need to be charged by the charity on the amount of the sponsorship payment.

There are other types of gifts involving benefits back to the donor that should be carefully scrutinized by charities in reviewing their fundraising programs. What is evident though, from even a brief review of donor restrictions involving name recognition is that there are limitations on the extent of benefits that a donor can receive from a gift; otherwise no gift will have been made and the charity will be unable to issue a charitable receipt.¹³⁰

10. Who Can Enforce Donor Restrictions?

(A) The Importance of Enforcing Donor Restrictions

Since a charitable purpose does not have beneficiaries who can initiate legal action to enforce donor restrictions and since many donor-restricted gifts continue in perpetuity, it is essential to establishing confidence in the process of charitable giving to know that there is either some authority that is responsible to enforce donor restrictions or there is a mechanism that interested individuals can initiate on their own to enforce the terms of the restriction.

(B) What Involvement Does the Government Have in Enforcing Donor Restrictions?

As there are no identifiable beneficiaries that can enforce a charitable purpose, the courts have recognized over the centuries that the Crown has an inherent *parens patriae* responsibility over charitable activities to represent and protect the interest of charities.¹³¹ This responsibility is exercised in Ontario by the Attorney General of Ontario through the Office of the Public Guardian and Trustee. This common law jurisdiction of the Crown has been supplemented by statute through the *Charities Accounting Act*, which provides the Public Guardian and Trustees Office with the ability to seek an order under s.4 of that *Act* if he or she is of the opinion that there has been a misapplication or misappropriation of any charitable funds, an improper or unauthorized investment of any monies, or failure to apply charitable property as directed by the donor. In addition, s.3 of the *Charities Accounting Act* allows the Public Guardian and Trustee to require a judicial passing of the accounts of a charity.

(C) Can Donors and/or Interested Individuals Enforce Donor Restrictions?

Generally speaking, once a donor has given a gift to a charity, the donor no longer has any interest in that property unless the gift is a conditional gift with a right of reversion to the donor or, on a *cy-près* application, the court is not prepared to apply the funds *cy-près* and the gift is returned to the donor. With the exception of these rare instances, the donor loses all control over the gift once it is given to a charity.

The ability of donors to enforce restrictions has been debated at some length in the United States, particularly when there has been a variation from the original intent of benefactors of large foundations, such as has occurred with the Barnes Foundation, the Carnegie Foundation, and the Ford Foundation.¹³²

In a decision of the Connecticut Supreme Court,¹³³ it was held that donors may not bring legal action against charities compelling them to honour conditions or limitations placed on charitable gifts. The decision was a result of legislation in the State of Connecticut that gives sole responsibility to the State Attorney General for ensuring that charities honor the terms or conditions attached to gifts. Under legislation in that state and in other states, in accordance with the *Uniform Management of Institutional Funds Act*, if a charitable purpose fails, then the state Attorney General may sue to compel compliance with the charitable purpose but donors have no legal right to bring such action on their own.

In Ontario, the Court of Appeal decision involving the McMichael Canadian Collection¹³⁴ dealt primarily with the interpretation of special legislation involving the creation and management of the McMichael Collection and, as such, the decision does not have broad application to most donor-restricted gifts. However, the nature of the complaint by the McMichaels was that the

Province of Ontario failed to honour the terms of a contractual agreement that had been signed with them when a gift of their collection and property was made to the Province in the 1960s. The case, although not decided in favour of the McMichaels, may very well provide impetus for other donors to argue breach of contract against a charity as an alternative to breach of trust, depending upon the wording of the particular donor agreement accompanying the gift.¹³⁵

What is interesting in relation to the *McMichael* case is that, although the McMichaels lost before the courts, they were successful in lobbying the Provincial Government to introduce legislation that reinstated the terms of the original agreement.¹³⁶ While the Provincial Government won at court based upon its prerogative to override private interests, the inequities resulting from the government failing to comply with a contractual arrangement evidentially carried the day. In commenting upon the introduction of remedial legislation, Robert McMichael was quoted as saying:

All the Premier is doing is honouring the agreement we made in 1965. After all, if a government signs something on behalf of Her Majesty and then changes it, well, that's like writing a phony cheque, isn't it?¹³⁷

Unlike in the United States, donors in Ontario do have a number of statutory opportunities to initiate a judicial review in the event that the donor or interested individuals are of the opinion that there has been a misapplication of special-purpose charitable trust funds or other failures to comply with donor-restricted charitable gifts. In this regard, s.6(1) of the *Charities Accounting Act* states that:

6.(1) Any person may complain as to the manner in which a person or organization has solicited or procured funds by way of contribution or gift from the public for any purpose, or as to the manner in which any of such funds have been dealt with or disposed of.

Applications under s.6(1) can be brought *ex parte* by a complainant, i.e., without notice to the charity or anyone else, with the court being able to order the Public Guardian and Trustee to conduct a public inquiry under the *Public Inquiries Act*.¹³⁸

In addition, s.10(1) of the *Charities Accounting Act* permits two or more individuals to make a court application where there is an alleged mismanagement or breach of trust involving charitable property:

10.(1) Where any two or more persons allege a breach of a trust created for a charitable purpose or seek the direction of the court for the administration of a trust for a charitable purpose, they may apply to the Ontario Court (General Division) and the court may hear the application and make such order as it considers just for the carrying out of the trust under the law.

A donor may also complain to the Public Guardian and Trustee that a “direction” imposed by the donor on a gift is not being complied with by the charity.

This in turn could result in an application by the Public Guardian and Trustee to obtain a court order requiring the charity to comply with the terms of the donor direction in accordance with s.4(d) of the *Charities Accounting Act*.

As a result, donors, family members of donors, and even unrelated members of the public have a number of effective statutory provisions under the *Charities Accounting Act* that can require a charity to account before a court how it has dealt with all aspects of charitable property that it has received, including donor-restricted charitable gifts. Board members of a charity should therefore be aware of the rights that donors and the public have in this regard, since they may be called to account, possibly in response to a court application.

11. Exigibility of Special Purpose Charitable Trusts

(A) Importance of the Issue

The decision of Feldman J.A. in *Christian Brothers Ont. C.A.* concerning the exigibility of special purpose charitable trusts is arguably one of the most significant cases involving charities in Canada. Since leave to appeal the decision to the Supreme Court of Canada has been denied, it is now important to consider the full impact of the pronouncement by the Ontario Court of Appeal. In this regard, it is expected that the decision of Feldman J.A. will create serious problems for charities in protecting their special purpose charitable trusts from tort creditors of the charity. The decision is also expected to have a serious impact upon the ability of charities to raise monies from donors, particularly monies for endowment funds in situations where donors presume that their gifts will be protected from creditors of the recipient charity.

As explained earlier in this article, Blair J. in the *Christian Brothers Gen. Div.* decision held that although the general corporate property of a charity is not immune from exigibility by tort creditors, property that is held as a special purpose charitable trust would not be available to compensate creditors of a charity unless the claim of the tort creditor arose from a wrong perpetrated within the framework of the particular special purpose charitable trust in question.

In the Ontario Court of Appeal decision, Feldman J.A. agreed with Blair J. that there was no general doctrine of charitable immunity applicable in Canada. However, Feldman J.A. stated that once Blair J. had determined that there was no doctrine of charitable immunity, it then became redundant for him to analyze whether the special purpose charitable trusts of a charity were exigible to pay the claims of tort creditors. Feldman J.A. concluded that:

For the purposes of this winding-up procedure, all assets of the [Christian Brothers], whether owned beneficially or on trust for one or more charitable purposes, are exigible and may be used by the Liquidator to pay the claims of the tort victims.

Unfortunately the result in the British Columbia decisions does little if anything to temper the impact of *Christian Brothers Ont. C.A.* Both B.C. courts declined to deal with the issue of the exigibility of special purpose trust funds for the benefit of a charity's tort creditors. Rather, they stated that the case as it was stated before them was restricted to determining the ownership of the assets and did not allow them to address the issue of exigibility. The courts accepted that while they were to determine ownership, the implications of that determination would depend on the decision of the Ontario courts. As mentioned earlier, Braidwood J.A. dissented, stating that it was open to the B.C. court to determine the legal ramifications of the determination of ownership. He agreed with Blair J. (in *Christian Brothers Gen. Div.*) that special purpose charitable trusts could only be available to tort creditors claiming for a wrong perpetrated within the framework of the particular special purpose trust. However, since leave to appeal to the Supreme Court of Canada was denied, Braidwood J.A.'s dissent has little impact on the practical result. Granted, the affirmation by the B.C. courts that special purpose charitable trusts do indeed exist in Canadian law may give donors some comfort in knowing that the charity recipient is legally, and not just morally, bound to use the donations for the donor's stated purposes. However, donors will have no assurance that their funds will not be used for completely unrelated purposes in the event that the charity becomes subject to tort claims which it is unable to satisfy from its other assets.

(B) Commentary on the Christian Brothers Ont. C.A. Decision

What follows is only a brief commentary concerning some aspects of the Ontario Court of Appeal decision:¹³⁹

- The decision that all assets held by a charity pursuant to special purpose charitable trusts are exigible by tort claimants of the charity, even if the wrongdoing was only with respect to one particular trust and not to the others, is in direct conflict with the long-standing principle at law that trust property held by a trustee is not exigible to satisfy a judgment against that trustee personally.¹⁴⁰
- Although not specifically expressed in the decision of Feldman J.A., the basis on which the Ontario Court of Appeal could conclude that special purpose charitable trusts were exigible and not run contrary to the established principles of trust law in relation to protection of trust property, is to draw a distinction between private trusts and charitable trusts. In this regard, there appears to be an underlying presumption by the Ontario Court of Appeal that special purpose charitable trusts held by a charity as the trustee are tantamount to an individual holding property in trust for the trustee personally, which would preclude a trust in the first place. This line of reasoning comes from a perception that special purpose charitable trusts do not have identifiable beneficiaries to enforce the trust and therefore it is as if the charity is holding the property

in question for itself, subject only to a trustee-like fiduciary obligation to comply with the expectations of the donor.

- What Feldman J.A. and, for that matter, counsel for the liquidator, failed to recognize, was that a basic attribute of a charitable purpose trust is that it is exempt from the requirement that there be identifiable beneficiaries.¹⁴¹ The reason why special status is given at law to a charitable purpose trust is that the public-at-large receives the benefit of the charitable purpose and as such, collectively, members of the public are considered to constitute the beneficiaries of the trust. Since it would be impossible for all members of the public to enforce the trust, it falls upon the Attorney General on behalf of the Crown to enforce the terms of the charitable purpose in accordance with its *parens patriae* role in overseeing charitable property. Given that a charitable purpose trust is as much a valid trust as a private trust, it follows that the ability of tort creditors to seize property held by a charity pursuant to a special purpose charitable trust could mean that any trust property held by a trustee, including property held pursuant to a private trust, might arguably be subject to claims against the trustee personally. This is clearly not the law in Canada. It is therefore unfortunate that leave to appeal to the Supreme Court of Canada was not granted so that the uncertainty resulting from the *Christian Brothers Ont. C.A.* decision on this issue could have been resolved.
- Feldman J.A., in an attempt to limit the impact of the decision, was careful to note that the Court of Appeal decision was limited to a very specific fact situation, i.e., only in instances where:
 - there are claims by tort victims against the charity;
 - the general assets of the charity are insufficient to satisfy the resulting judgments;
 - the charity is no longer operating; and
 - the charity has been wound up pursuant to a winding-up order under the *Winding-Up and Restructuring Act*.

These limitations, though, are arbitrary in nature and provide little comfort to charities and their legal counsel who may be concerned that the decision could become the “thin edge of the wedge” that could lead to future court decisions exposing special purpose trusts’ property, such as endowment funds, to claims by tort victims in a broader context instead of only in the limited fact situation involving the *Christian Brothers* case.

(C) Impact of the Christian Brothers Ont. C.A. Decision

The *Christian Brothers Ont. C.A.* decision will probably have a negative impact on the operations of charities across Canada in at least six crucial ways:

- Tort victims will now be encouraged to pursue claims against charities, particularly larger charities, knowing that there may be “deep pockets” that were previously untouchable but can now be readily accessed.
- Property and/or funds held as special purpose charitable trusts, particularly endowment funds, that many charities depend upon for their continued existence, will now be susceptible to claims by tort victims. This in turn may prejudice the ability of some charities to continue operating and could result in either the bankruptcy or forced distribution of funds for some charities that are particularly vulnerable, such as religious denominations, local churches and educational institutions.
- The ability of donors to create enforceable special purpose trusts will be thwarted where claims by tort creditors cause those special purpose charitable trusts to be applied in ways totally different from that which was originally contemplated by the donors. Such a result ignores the overriding jurisdiction and mandate of the court to apply a special purpose charitable trust *cy-près* where the original charitable purpose has become either impossible or impracticable.
- Donors will be reluctant to give large gifts (such as endowment funds) directly to charities that otherwise had been thought to be protected from creditors as special purpose charitable trusts when no assurance can be given to donors that the special purpose charitable trusts will be immune from present or future creditors of the charity.
- International charities may be reluctant to set up operations in Canada for fear that they might arguably be exposing their global assets to claims by tort creditors in Canada.
- Lawyers might be found liable if they fail to advise clients, either charities or donors, that special purpose charitable trusts are no longer protected from the claims of tort creditors and that alternatives should be canvassed in an attempt to “credit-proof” special purpose charitable trusts as much as possible.¹⁴²

The combined overall “chill effect” that will likely result from the negative impact of *Christian Brothers Ont. C.A.* may very well prejudice the financial stability of a large segment of the charitable sector in Canada and could even affect its long-term viability. This in turn may require that various levels of government may need to fill the void that could result in the loss of social services currently being provided by charities that could be seriously affected by the decision.

(D) Developing a Strategy in Response

Since it is uncertain whether anything effective can be done to “credit-proof” existing special purpose charitable trusts, the task for lawyers in advising charities and donors will be to focus on how to structure future special purpose charitable gifts so that they will not become exigible by tort creditors of the

charity. Some strategies that legal counsel may want to consider in advising charities and donors on this issue include:

- Creating a special purpose charitable trust by the donor giving the intended gift to an arm's-length parallel foundation established to advance only the purposes of the intended charity;
- Creating a special purpose charitable trust by the donor giving the intended gift to a community foundation or trust company to be held in trust for the benefit of a specific named charity; or
- Structuring a donation as a determinable gift to be determined upon the winding-up, dissolution or bankruptcy of the charity, accompanied by a "gift over" to another charity that had similar charitable purposes or, alternatively, providing that the gift revert to the donor.¹⁴³

All of these options and, in particular, the use of conditional gifts, would require addressing a number of important legal issues, including determining the income tax consequences to the donor in making the gift. (Some of these have been addressed earlier in this article and elsewhere.)¹⁴⁴

12. How Should Donor-Restricted Gifts Be Managed Once Received?

Often, a charity will run into difficulties in dealing with donor-restricted charitable gifts due to either a lack of understanding of the legal consequences arising from such gifts or a failure by the charity to implement appropriate policies to effectively manage donor-restricted charitable gifts once received. The following provides a brief summary of some of the practical considerations that should be addressed by a charity, its board of directors, management, and fundraisers in effectively managing donor-restricted charitable gifts:

(A) Identifying the Nature of the Charitable Gift

Since the legal consequences are very serious, it is important for a charity to retain the assistance of legal counsel in drafting guidelines to identify the legal distinctions in relation to gifts received. These guidelines should provide examples of gifts that are subject to terms, restrictions, or conditions that will need to be scrutinized to determine whether or not they may constitute donor-restricted charitable trusts, as well as providing examples of gifts that are clearly unrestricted.

In the event that there were any questions concerning the nature of the gift, then the instrument creating the gift should be forwarded to legal counsel for the charity so that an appropriate legal opinion can be obtained. If a determination is made that the gift constitutes a donor-restricted charitable gift, then the gift would need to be identified as such and subsequently treated as a special purpose charitable trust.

(B) Reviewing and Approving Donor Restrictions

Whenever a gift is identified as a donor-restricted charitable gift, it is important that the management of the charity carefully review the terms of the donor restrictions to ensure that the following questions are addressed:

- Are the restrictions charitable?
- If so, are the restrictions within the charitable purposes of the charity?
- Are the restrictions both possible and practicable?
- If they are, then are the restrictions acceptable to the charity?
- If any of these questions is answered in the negative, then the charity should not accept the gift, the gift should be returned to the donor, and no charitable tax receipt should be issued.
- Alternatively, if the gift is subject to restrictions that the charity wishes to accept but such restrictions are either impossible or impractical, then the charity would need to apply to a court to have the court exercise its *cy-près* scheme-making power to vary the terms of the donor-restricted charitable trust “as near as possible” to the original restrictions imposed by the donor.

(C) Effective Ongoing Management of Donor-Restricted Charitable Gifts

Once a decision is made to accept a donor-restricted charitable gift, then the charity and its management must be careful to ensure that the funds in question are managed as charitable trust funds. Appropriate management would involve:¹⁴⁵

- Since a donor-restricted charitable gift is by its very nature given to a specific charity or trustee, the gift must be deposited into the bank account of that charity and used by that charity for the stated charitable purposes, unless the objects and power clauses of the named charity permit the funds to be subsequently transferred to another charity.
- Donor-restricted charitable funds must be invested in accordance with the specific investment powers set out in the document creating the restricted charitable trust or, if there is no special investment clause, in accordance with the general investment powers of the charity.
- The charity must never borrow against donor-restricted charitable funds, whether to further other charitable purposes of the charity or to underwrite the general operations of the charity, notwithstanding that the board may intend to repay the monies at a later time with interest.
- At common law, each donor-restricted trust fund is required to be held separately from other restricted trust funds and cannot be co-mingled though very few charities comply with this common law prohibition against co-mingling. As such, it is anticipated that pending regulations under s.5.1 of the *Charities Accounting Act* will permit co-mingling of

restricted funds by a charity; however, it is likely that such regulations will impose some restrictions on the ability to co-mingle.

- Since donor-restricted charitable gifts are often testamentary gifts, it is important for the charity to maintain ongoing communication with family members of the testator to provide information and confirmation of compliance by the charity with the applicable restrictions. Good communication in this regard can help to avoid misunderstandings in the future between family members of the testator and the charity that might otherwise lead to legal action.
- A transfer of a donor-restricted charitable trust from one charity to another will require, at the very least, a written appointment in accordance with s.3 of the *Trustee Act* to document a change in trustees. A transfer may also require court authorization pursuant to a consent order obtained under s.13.(1) of the *Charities Accounting Act* in the event that the nature of the donor restriction contemplated that the role of the named charity as the trustee of the fund was a fundamental term of the donor-restricted charitable trust.
- The proceeds realized from the sale of charitable property that is subject to a special purpose charitable trust, such as a trust deed for church property, will remain impressed with the terms of that trust and may have to be accounted for as a special purpose charitable trust fund on a perpetual basis, unless court approval is first received to vary the terms in accordance with a *cy-près* application.

13. How Can Donor-Restricted Charitable Gifts Be Avoided in the First Instance?

Since donor-restricted charitable gifts involve considerable legal responsibility and exposure to liability, an important question that a charity should ask is what can be done on a practical basis to encourage donors to give unrestricted rather than restricted charitable gifts. This is not to suggest that there is not a place for donor-restricted gifts; however, a program of good legal risk management in avoiding breach of trust should involve taking positive steps to avoid situations that might otherwise give rise to a breach of trust before they occur instead of trying to remedy the problem after the fact.

Some practical suggestions include:

- The simplest approach is to encourage donors to give unrestricted gifts, wherever possible. This could be done by providing sample bequest clauses that make reference to the general purposes of the charity without suggesting the option of a restricted gift, e.g., “to ABC charity for its general charitable purposes”.
- If a donor wanted to give directions concerning how a gift was to be used, then the donor could be encouraged to use wording that constitutes

“suggestions” only as opposed to binding restrictions, e.g., “to ABC charity, with the request, but not the legal obligation, that the gift be used for _____”.

- Fundraisers should understand and be able to identify the difference between unrestricted charitable gifts and donor-restricted charitable gifts, so that they can encourage donors to focus on the flexibility of an unrestricted gift.
- As a precautionary measure, fundraising materials should include a statement to explain that all gifts will be considered to have been given to further the general charitable purposes of the charity in accordance with its needs from time to time, unless the donor has specifically stated that the gift is to be subject to binding restrictions, in which event the donor would be encouraged to contact the charity to discuss the specific terms of the restriction before making such a gift.

14. Preventive Steps to Reduce Liability Involving Donor-Restricted Charitable Gifts

Since it is not realistic to expect that all future gifts that a charity will receive will be of an unrestricted nature, it is important for a charity also to develop and implement a policy to reduce the risks associated with receiving donor-restricted charitable gifts. Considerations should include:

- Public fundraising appeals for a specific program, such as monies required for a building program, should contain a clear statement that any surplus monies remaining after the necessary funds have been raised for the designated project or program will be used to further the general charitable purposes of the charity. This would avoid the charity having to make a *cy-près* court application to obtain a judicial direction.
- Suggested wording given to a prospective donor and the donor’s solicitor concerning an estate legacy where a donor wants to include a restricted charitable gift should include a standard *cy-près* clause in the will so that the charity will be able to unilaterally modify the restrictions imposed by the donor in the event that such restrictions become impossible or impracticable in the future.
- To avoid a donor-restricted charitable gift subsequently failing and the gift reverting to either the donor or to the beneficiaries of a testator, it is important that the wording used in the document creating the restricted gift, such as the will, use clear language to identify the specific charitable purpose for which the monies are to be used and who the beneficiary is to be; otherwise, the gift may fail altogether for lack of certainty.¹⁴⁶ In this regard, and in accordance with *Christian Brothers Gen. Div.*, it would be prudent to include language that shows clearly that a charitable trust has been created, e.g., using the phrase “in trust,” and to ensure that

the formalities of the three certainties of a trust are met, i.e., who is the trustee? what is the trust property? and what is the charitable purpose?

- In the event that the donor intends to give endowment funds where the capital is to be held in perpetuity and the interest income is to be used for operational purposes of the charity, the donor should be encouraged to place only general restrictions on how the income can be used. In any event, the donor should include a *cy-près* clause so that the restriction can be unilaterally varied. The inclusion of such a clause would ensure that the charity would have the ability to redirect the income earned from the endowment fund in the event that the restrictions concerning how the income is to be used became impossible or impracticable to honour.

15. Conclusion

The issues involving donor-restricted charitable gifts are many and complex. This article has touched on only some of the more important matters that must be addressed so lawyers who are called upon to provide a legal opinion in this grey area of the law should conduct their own research and not rely solely on these comments.

Notwithstanding the complexities of the issues, given the increased demands on fundraising for charities and the associated need for innovative and sophisticated gifts, there is little doubt that the importance of addressing and understanding the issues involved with donor-restricted charitable gifts will become more, not less, important to the future operations of charities. It is therefore incumbent upon lawyers who practise in this area of the law, as well as chief executive officers and boards, to ensure that they take the time to become familiar with this interesting, but often convoluted, area of the law.

FOOTNOTES

70. *Supra*, footnote 11, at 396.
71. *Ibid.*
72. Gammon & Grange, P.C., “Non-profit Alert, Avoiding the Pitfalls of Donor-Designated Gifts” (Washington D.C., NP9302-1, 1997) 703761-5000. 72 R.S.C. 1998, c. 19, s.22.
73. R.S.C. 1998, c. 19, s.22.
74. Hubert Picarda, *The Law and Practice Relating to Charities*, 2nd ed. (London: Butterworths, 1995), p. 202.
75. Tudor, *supra*, footnote 22, pp. 146–147.
76. *Supra*, footnote 6, p. 408.
77. *Supra*, footnote 8, p. 248.
78. Waters, *supra*, footnote 22, p. 143.
79. *Supra*, footnote 8, p. 231.
80. *Supra*, footnote 22, p. 143.
81. *Ibid.*, p. 147.

82. *Supra*, footnote 74, pp. 202–203.
83. *Supra*, footnote 22, p. 142.
84. *Ibid.*, p. 432.
85. *Weir v. Crum-Brown*, [1908] A.C. 162, at 167, 77 L.J.P.C. 41 (H.L.), p. 127.
86. *Supra*, footnote 6, p. 401.
87. *Clapper (Re)*, [1910] 2 O.W.N. 111 (H.C.J.); *Hogle (Re)*, [1939] 4 D.L.R. 817, [1939] O.R. 425 (S.C.).
88. *Stewart (Re); Royal Trust Co. v. Stewart* (1958), 13 D.L.R. (2d) 654 (B.C.S.C.); *Ogilvy v. Ogilvy*, [1953] 1 D.L.R. 44, [1952] O.W.N. 625 (H.C.); *Gordon (Re)* (1965), 52 D.L.R. (2d) 197, [1965] 2 O.R. 805 (H.C.J.); *Hunter (Re)* (1973), 34 D.L.R. (3d) 602, [1973] 3 W.W.R. 197 (B.C.S.C.).
89. *Supra*, footnote 74, p. 202.
90. *Supra*, footnote 22, pp. 245–246. See also Picarda, *supra*, footnote 70, p. 367.
91. George G. Bogert, *The Law of Trust and Trustees*, 2nd ed. (St. Paul: West Publishing, 1964), para. 431, p. 490.
92. *Supra*, footnote 5, at para. 399.
93. For a thorough discussion of the convoluted issues involved in applying the *cy-près* doctrine to surpluses from public fundraising campaigns, reference should be made to James Phillips, “The Problem of Surpluses in Funds Raised By Public Appeal” (1990), 9 *Philanthrop.*, No. 1, p. 3.
94. *Supra*, footnote 6, pp. 403 and 405.
95. *Supra*, footnote 31.
96. Tudor, *supra*, footnote 22, p. 394; see also H.A.J. Ford and W.A. Lee, *Principles of the Law of Trust*, 3rd ed. (North Ryde, N.S.W.: LBC Information Services, 1996); see also Waters, *supra*, footnote 8, pp. 620–621.
97. See *McMichael v. Ontario* (1997), 154 D.L.R. (4th) 50, 36 O.R. (3d) 163, 105 O.A.C. 161 (C.A.), leave to appeal to S.C.C. refused 159 D.L.R. (4th) vii, 227 N.R. 395n.
98. *Supra*, footnote 6, p. 429.
99. See *Baker (Re)* (1984), 11 D.L.R. (4th) 430, 47 O.R. (2d) 415, 17 E.T.R. 168 (H.C.J.); *Bell (Re)* (1980), 112 D.L.R. (3d) 573, 29 O.R. (2d) 278, 7 E.T.R. 129 (H.C.J.); see also *supra*, footnote 6, p. 431.
100. *Supra*, footnote 6, p. 431.
101. Chris Abbinanet, “Protecting ‘Donor Intent’ in Charitable Foundations: Wayward Trusteeship and the Barnes Foundation” (1997), 145 U. Pa. L. Rev. 665 p. 683.
102. *Supra*, footnote 97.
103. *McMichael Canadian Art Collection Act 2000*, R.S.O. 1990, c. M. 4.
104. *Supra*, footnote 22, p. 245; *supra*, footnote 74, p. 367.
105. *Ibid.*, see also *Young Women’s Christian Association Extension Campaign Fund (Re)*, *supra*, footnote 31 and *Baker (Re)*, *supra*, footnote 99.
106. *Trustee Act*, R.S.O. 1990, c. T.23.
107. For a more detailed discussion of the duties and obligations arising from investments of charitable funds, see Timothy G. Youdan, “Investments Made By Trustees” (Paper presented to Canadian Bar Association of Ontario, at *Charities and Not-For-Profit Law*, 1998) [unpublished] and “Investment by Charities” (Paper presented to the Law Society of Upper Canada, at *Fit to be Tithed II*, 1998) [unpublished].

108. *Supra*, footnote 22, p. 254.
109. Enacted by S.O. 1997, c. 23, s.3(4) (Bill 61).
110. *Supra*, footnote 22, p. 254; *supra*, footnote 74, p. 367.
111. *Supra*, footnote 74, p. 374.
112. Section 5.1 amended by 1996, c. 25, s.2(1) (Bill 79).
113. See *Public Trustee v. Toronto Humane Society* (1987), 40 D.L.R. (4th) 111, 60 O.R. (2d) 236, 27 E.T.R. 40 (H.C.J.); *David Feldman Charitable Foundation (Re)* (1987), 58 O.R. (2d) 626, 26 E.T.R. 86 (Surr. Ct.); *Faith Haven Bible Training Centre (Re)* (1988), 29 E.T.R. 198 (Ont. Surr. Ct.); *Harold G. Fox Education Fund v. Public Trustee* (1989), 69 O.R. (2d) 742, 34 E.T.R. 113 (H.C.J.).
114. *Anglican Diocese of Algoma v. Algoma University*, *supra*, footnote 60.
115. *Public Inquiries Act*, R.S.O. 1990, c. P. 41.
116. R.S.C. 1985, c. c-46.
117. Bill 25 (*Red Tape Reduction Act*) 1998, 2nd Sess., 36 Leg. Ont., 1998, Third Reading—November 30, 1998, proclaimed in effect on July 1, 1999. For a commentary on the impact of Bill 25 see Terrance S. Carter, “The Application of the New ‘Prudent Investor’ Standard for Charities in Ontario”, *Lawyers Weekly*, (November 19, 1997); also see Terrance S. Carter, “Proposed New ‘Prudent Investor’ Standard for Charities in Ontario and Practical Consequences of the Proposed ‘Prudent Investor’ Rule for Charities”, Canadian Bar Association of Ontario, *Briefly Speaking* (January 9, 1998); and *Charity and the Law Update*, Vol. 1, Nos. 2, 3, 4, 5 and 6, available on the internet at www.charitylaw.ca.
118. For a more detailed discussion of the impact of Bill 61 on the *Charities Accounting Act*, see Heather G. Hisey, “Bills 61 and 794 – Charities Accounting Act of Ontario”, Canadian Bar Association of Ontario, *Charities and Not-For-Profit Law* (April 24, 1998).
119. Information Circular 80-10R *Registered Charities: Operating a Registered Charity*, para. 37, Part IV.
120. Letter of Carl Juneau, Director of Policy and Communications Division Charities’ Directorate, Canada Customs and Revenue Agency to Terrance Carter (21 September, 2000).
121. *Supra*, footnote 8, p. 136.
122. *Ibid.*, p. 153.
123. Short, TCM 1997-255; *Hope*, 68 AFTR (2d) 91-5396 (Cls. Ct., 1991); *Goldstein*, 89 T.C. 535 (1987).
124. For a more detailed discussion of the tax treatment of donor-advised funds in the United States see Susan R. Bills, “Donor-Advised Funds Pose Competition for Community Foundations”, Vol.11/No.3, *Journal of Taxation of Exempt Organizations*, (November/December 1999) p. 114; John McGowan Jr., “Major Charitable Gifts – How Much Control Can Donors Keep and Charities Give Up?”, *Journal of Taxation*, (November 1999) p. 280; Blasi and Denesha “Avoiding Disallowance of Earmarked Charitable Contributions”, 9 *Rev. of Tax’n of Indivs.* 160 (Spring 1985); Teitell, “Charitable Gifts with Strings Attached”, 24 *U. Miami Inst. on Est. Plan.* 16-1 (1990); Shoemaker and Henchey, “Donor Directed Funds”, Continuing Professional Education, *Exempt Organizations Technical Instruction Program for FY 1996* (1995), 343.
125. *Ibid.*, Bills, p. 155.
126. *Ibid.*, p. 115.

127. *Ibid.*, p. 116.
128. *Black's Law Dictionary*, *supra*, footnote 4.
129. See Margaret Philip, "A Good Cause Is Not Enough Nowadays", *The Globe and Mail* (9 October 2000) A14 for examples of businesses which are developing strategies to benefit both the business and charity.
130. For further information concerning the limit of donor restrictions providing a benefit back to the donor, see *Charity Newsletter No. 9* (December 2000), as well as Terrance S. Carter, "Looking a Gift Horse in the Mouth: Avoiding Liability in Charitable Fundraising". (Paper originally presented at the Law Society of Upper Canada *Second Annual Estates and Trust Forum*, 1999) (available in an updated version as of October 2001 at www.charitylaw.ca).
131. Waters, *supra*, footnote 8, p. 128; Ontario Law Reform Commission, *supra*, footnote 6, pp. 390–391.
132. *Supra*, footnote 101.
133. *Carl J. Herzog Foundation v. University of Bridgeport* (Conn. Sup. Ct.1997). See *supra*, footnote 72, p. 1.
134. *Supra*, footnote 97.
135. See also the April 9, 1998 issue of *The Chronicle of Philanthropy* (Washington) for a report of a New York ruling resulting in the return of \$3,000,000 from a Lubavitch School to a donor for breach of a contract entered into with the school concerning terms of the gift.
136. *Supra*, footnote 103.
137. Sarah Hampson, "At the Heart of a Deal: Why the McMichaels Fought so Hard to Protect their Gallery's Legacy", *The Globe and Mail*, (13 July 2000) *The Globe Review*.
138. For a more complete discussion of the effect of s.6 of the *Charities Accounting Act* and the applicable case law under it, see *supra*, footnote 3, pp. 272–274.
139. For a thorough analysis of this decision see David Stevens, "An Analysis of the Christian Brothers Decisions". (Paper presented at the First Annual Charity Law Symposium, *Fundamental New Developments in the Law of Charity*, Canadian Bar Association of Ontario, Toronto, 2000.) [unpublished].
140. *Jellet v. Wilkie* (1896), 26 S.C.R. 282, at 288.
141. *Supra*, footnote 6.
142. For an in-depth discussion about judgment proofing in the nonprofit context see K. Davis, "Vicarious Liability, Judgment Proofing and Non-Profits" (2002), 50 *UTLJ* 407.
143. Although a condition subsequent against forfeiture on bankruptcy would be void, a limitation in the form of a determinable interest until bankruptcy has been held to be valid. See John McGhee, ed., *Snell's Equity*, 30th ed. (London: Sweet & Maxwell, 2000), pp. 160–161. See also Jill E. Martin, ed., *Hanbury & Martin: Modern Equity*, 15th ed., (London: Sweet & Maxwell, 1997), pp. 186–187.
144. See Carter, *supra*, footnote 130. (available at www.charitylaw.ca).
145. *Ibid.*, p. 186.
146. See *Muir v. Muir* (1995), 7 E.T.R. (2d) 58 Ont. Ct. (Gen. Div.); and *O'Neill Community Ratepayers Association v. Oshawa (City)* (1995), 22 O.R. (3d) 648 Ont. Ct. (Gen. Div.).