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**Donor-Restricted Charitable Gifts:
A Practical Overview Revisited II**
(originally published September/December 2003)

By Terrance S. Carter, B.A., LL.B.
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DONOR-RESTRICTED CHARITABLE GIFTS: A PRACTICAL OVERVIEW REVISITED II

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A. INTRODUCTION

Since the presentation on which this article is based, there has been considerable public recognition of the importance of donor-restricted charitable gifts. This increased recognition has occurred because of a realization that with the new generation of philanthropists, a different approach to charitable giving which recognizes the importance of accommodating the donor's wishes as well as the expectations of the charity, is emerging. As stated by a senior fundraiser:

Philanthropy has become *donor rather than cause centred*. Altruism has become self-interested, and we now have the *donor-consumer ... What will move donors is their wants, not our needs.*¹ [emphasis added]

This “donor centred” approach to philanthropy is in part a reflection of the “Baby Boomer” generation’s need to dominate and control all aspects of their lives. As the Boomers reach their forties and fifties, they are no longer prepared to part with their wealth by leaving it in the sole control of the charity. Instead, they are insisting on exercising some measure of control over their gifts. In a *Time Magazine* article on “The New Philanthropy,” the following observation was made:

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¹ Mark Sarner, “The Capital Campaign: Capital Fundraising at the Millennium”, *Canadian Fundraiser* (August 16, 2000) at 6.

Silicone Valley Chief Executive Officers, along with other newly rich Americans, are finally stepping up to the collection plate. And just as they transformed American business, members of the new generation are changing the way philanthropy is done. *Most are very hands on.*² [emphasis added]

As a result of the greater demand by donors to exercise control over their gifts, there is an increasing obligation placed upon charities and their legal counsel to ensure that restrictions imposed by donors are respected, while at the same time ensuring that the charity is able to comply with those restrictions, and making sure that they do not unnecessarily expose the charity and its board of directors to legal liability. Thus, the following article provides greater focus on situations in which charities and their boards of directors may be exposed to liability, and what practical steps can be taken to avoid such risks.

B. SETTING THE STAGE

The following scenario provides an illustration of a typical situation which is not uncommonly faced by lawyers who advise charities.

As legal counsel for a financially troubled charity which operates a youth centre for street kids, you are asked to advise on the legal implications of the charity ceasing to operate. The board is contemplating a possible amalgamation with another charity or, alternatively, dissolving the charity and transferring its remaining assets to another charity that has similar charitable objectives. In reviewing a copy of the current financial statement for the charity, you notice that there is a reference in the statement to the “Simpson Endowment Fund”. As part of your due diligence in advising the charity, you ask for details.

You are advised that the Fund was established years ago when Mr. Simpson died. He left \$50,000 to the charity to be used to build a gym as an addition to the youth centre. Unfortunately, the gym addition was never built because the \$50,000 gift from the Simpson estate was insufficient to ensure the completion of the project and monies could not be raised from other supporters. When you asked why the current balance in the “Simpson Endowment Fund” is now only \$20,000 instead of the original \$50,000 plus accrued interest, you are advised that, on occasion over the last years, the board has had to use some of the fund to balance the operating budget of the youth centre.

² Karl Taro Greenfield, “A New Way of Giving”, *Time Magazine*, July 24, 2000 at 39.

At a board meeting, one of the new members who was not aware of the history of the Fund asks you whether or not the Fund has been properly dealt with and, if not, what the legal implications are for the charity and its board of directors and what should be done to rectify any irregularities if they have occurred. To assist those who may face similar problems, this article will provide an overview of the more important issues that arise in dealing with charitable gifts that are subject to donor restrictions, whether those restrictions are in the form of an endowment, a conditional gift, or a restricted purpose trust fund. The difficulty in attempting such a task, though, is that every issue raised in this grey area of the law leads to myriad related matters which must be considered so it is easy to become confused by the numerous questions that should be addressed.

In addition, the legal and equitable principles that arise are often complex and murky, involving complicated concepts of trust law, corporate law, the law of associations, contract law and, more currently, income tax law. Although there are numerous textbooks and articles dealing with many of the individual legal issues involving donor-restricted charitable gifts, there do not appear to be any published materials that provide one source dealing with all of the various legal issues. This article is not meant to be a comprehensive analysis of the law in this area. Instead, it is intended to provide a practical overview of the relevant issues for lawyers, executive directors, fundraisers and interested members of boards of directors of charities. In this regard, the article can most effectively be used as an initial reference tool or guide, similar to a rough set of “Coles Notes,” that can be consulted before proceeding with the more thorough research required to provide a competent legal opinion for a client.³

C. PRELIMINARY LEGAL CONSIDERATIONS

1. The Legal Nature of a Gift

What constitutes a “charitable gift”? For ease of use, reference is made to *Black’s Law Dictionary* for a standard definition of what is a gift in law:

³ For a more detailed discussion of an approach involving pro-active legal advice, see Terrance S. Carter, “Advising the Charitable Client: Pro-Active Legal Risk Management Advice”, Law Society of Upper Canada, *Special Lectures*, 1996 (Carswell: Toronto, 1996) at 267.

Gift – a voluntary transfer of property to another made gratuitously and without considerations.⁴

2. What Is the Basic Nature of a Charitable Purpose?

The other fundamental consideration in understanding donor-restricted charitable gifts involves an appreciation of the special nature of a charitable purpose and its impact on different forms of such gifts. A selected discussion of the characteristics and key issues involving charitable purposes is set out below.

3. What Is the Definition of a “Charitable Purpose?”

The term is generally used in the context of a charitable purpose trust but has application to other legal forms of charities as well. The *Restatement of Trusts*⁵ defines a charitable purpose trust as follows:

A charitable purpose trust is a fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose.

The Ontario Law Reform Commission, *Report on the Law of Charities*⁶ summarizes the basic nature of a charitable purpose trust as follows:

... a promise or undertaking made by the initial trustee, followed by undertakings of his or her successor trustees, to apply a certain locus of wealth, sometimes in perpetuity, to a particular purpose. So analyzed, it is more akin to an oath or a vow, albeit legally enforceable, than to a bilateral contract. It is this feature that gives it its special and problematic juridical character.

⁴ See *Black’s Law Dictionary*, 6th ed., s.v. “gift”. For an overview of the legal issues that are involved in determining what legally constitutes a gift, see Arthur B.C. Drache, Q.C., “A Gift By Any Other Name May Not Be A Gift,” *Charities and Not-For-Profit Law*, Canadian Bar Association of Ontario, April 24, 1998.

⁵ American Law Institute, *Restatement (Second) of Trusts* (Washington, D.C.: 1959) at para. 348.

⁶ Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ministry of the Attorney General, 1996) at 395.

4. What Are the Basic Attributes of a Charitable Purpose Trust?

Compared to other forms of trusts, a charitable purpose trust has certain beneficial attributes which are unique to it. Those attributes are summarized as follows:⁷

- A charitable purpose trust is exempt from a requirement that there be a beneficiary of the trust. This means that there is no one to enforce the trust other than the Attorney General in accordance with that office's traditional *parens patriae* role in overseeing charitable purposes.
- A charitable purpose trust will not fail for uncertainty of objects even though there are no identifiable beneficiaries, provided that the purpose is exclusively charitable.
- The court is prepared to write or rewrite a charitable purpose trust in certain limited circumstances discussed later in this article by supplying a *cy-près* scheme i.e., by making the charitable objects "as near as possible" so that the charitable purpose intended by the donor can continue to be achieved.⁸
- A charitable purpose trust is exempt from the prohibition against remoteness of vesting, otherwise known as the "modern" rule against perpetuities. This rule would otherwise require that a contingent interest in property vest within the perpetuity period, i.e., the length of any life in being at the time the instrument establishing the contingent interest is created plus 21 years. Section 4 of the *Perpetuities Act* reformed the rule against perpetuities so that instead of asking "what could conceivably happen," we now "wait and see" whether the interest under consideration in fact vests within the perpetuity period. As a result, in Ontario a contingent interest is void only if it must vest, or actually does vest, outside the perpetuity period.⁹ With regard to a charitable purpose, the exemption from the rule against remoteness of vesting means that a charitable purpose is "liberated" from rules prohibiting remote conditional interests.
- A charitable purpose trust is exempt from the prohibition against indestructible or perpetual trusts. This rule would otherwise prohibit the tying up of capital in trust where it is

⁷ *Ibid.* at 395–414.

⁸ See D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984) at 502.

⁹ *Supra* note 6 at 407, and the *Perpetuities Act*, R.S.O. 1990, c. P-9, s.16.

impossible to identify the absolute equitable owners for a period greater than the perpetuity period. This means that both property and funds held by a charity can be held in perpetuity without violating any rule of law.

5. Does a Charitable Purpose Trust Have Application To a Charitable Corporation?

The issues involved in determining whether a charitable purpose trust has application to a charitable corporation are a highly confused and unsatisfactory area of the law.¹⁰ The main aspect of this question is whether a charitable corporation holds its assets “in trust” for its charitable purposes. The difficulty is that the case law has been divergent on this issue.¹¹ As well, this issue has been further confused in Ontario as a result of section 1(2) of the *Charities Accounting Act*,¹² which states that a charitable corporation is a trustee of its property for purposes of that *Act*.

American legal authorities have commented upon this grey area of the law as follows:¹³

The truth is that it cannot be stated dogmatically that a charitable corporation neither is or is not a trustee. The question is in each case whether a rule that is applicable to trustees is applicable to charitable corporations with respect to unrestricted or restricted property. Ordinarily, the rules that are applicable to charitable trusts are applicable to charitable corporations, as we have seen, although some are not...

Generally speaking, the attributes of a charitable purpose trust will have application to a charitable corporation when the corporation holds property in accordance with a special purpose charitable trust (discussed further below). The same attributes will also apply, but in a different sense, with regard to unrestricted charitable property of a charitable corporation.

¹⁰ For a thorough discussion concerning the interrelationship between charitable purpose trusts and charitable corporations, see Cullity J., “The Charitable Corporation: A ‘Bastard’ Legal Form Revisited”, attachment to 17 *Philanthrop*. No 3.

¹¹ For a discussion of the divergent case law on this topic, see Ontario Law Reform Commission, *supra* note 6 at 456–460. See also *Christian Brothers of Ireland in Canada (Re)* (1998), 37 O.R. (3d) 367 (Ont. Ct. (Gen. Div)), 21 E.T.R. (2d) 117, rev’d (2000), 47 O.R. (3d) 674 (Ont. C.A.) [*Christian Brothers Gen. Div.*]; *Christian Brothers of Ireland in Canada (Re)*, (2000), 47 O.R. (3d) 674 (Ont. C.A.), rev’g (1998), 37 O.R. (3d) 367, application for leave to appeal to the Supreme Court of Canada dismissed, November 16, 2000 [*Christian Brothers Ont. C.A.*]; *Rowland v. Vancouver College Ltd.* (2000), 78 B.C.L.R. (3d) 87 (S.C.), 34 E.T.R. (2d) 60, aff’d (2001), 94 B.C.L.R. (3d) 249 (C.A.) [*Christian Brothers B.C.S.C.*]; *Rowland v. Vancouver College Ltd.* (2001), 94 B.C.L.R. (3d) 249 (C.A.), aff’g 78 B.C.L.R. (3d) 87 (S.C.), application for leave to appeal to the Supreme Court of Canada dismissed, May 23, 2002 [*Christian Brothers B.C.C.A.*].

¹² *Charities Accounting Act*, R.S.O. 1990, c. C-10.

¹³ A.W. Scott, *The Law of Trusts*, 4th ed. By W.F. Fratcher, vol. 4A (Boston: Little, Brown & Company, 1989), para. 348.1 at 23–25.

From the *Christian Brothers* decisions, it is clear that a charitable corporation does not hold its unrestricted assets “in trust” for its charitable purposes. Instead, it owns such assets beneficially to be used in accordance with its corporate objects. This was noted by Blair J. in *Christian Brothers Gen. Div.* as follows:

A charitable corporation does not hold its assets “as trustee” for charitable purposes... It holds its assets beneficially, like any other corporation. As a matter of corporate law, of course, it must use those assets in a manner consistent with its corporate objects, and its directors have fiduciary obligations to ensure that such is the case. Where its corporate objects and its charitable purposes coincide – as they do in this case – it must use its assets in a manner consistent with those charitable purposes. Nevertheless, this does not mean that it holds all of its assets in some kind of trust capacity.¹⁴

In the end, while it may be said that for some purposes a charitable corporation is in a position analogous to that of a trustee with respect to the use and disposition of its property – at least with respect to the court’s power to exercise its “ancient supervisory equitable jurisdiction” over it – the weight of authority supports the conclusion that its assets are not held by it “as trustee” for its charitable objects, but are owned beneficially to be used by the corporation in a fashion consistent with its objects.¹⁵

This position was confirmed by the Ontario Court of Appeal in *Christian Brothers Ont. C.A.*¹⁶ The British Columbia Supreme Court also came to the same conclusion involving the assets of the Christian Brothers located in that province.¹⁷ As such, it is now generally accepted that unrestricted property of a charitable corporation is not to be construed as trust property held by a charitable corporation for its charitable purposes.

In a practical context, this means that a charity may use an unrestricted gift to the full extent of its charitable objects based upon its corporate authority as a legal entity without having to interpose a charitable purpose trust to establish either the legal authority or the parameters within which the gift

¹⁴ *Christian Brothers Gen. Div.*, *supra* note 11 at 390–91.

¹⁵ *Ibid* at 392.

¹⁶ *Christian Brothers Ont. C.A.*, *supra* note 11 at 701–702.

¹⁷ *Christian Brothers B.C.S.C.*, *supra* note 11 at 110 and 153–154. While the B.C. Court of Appeal in *Christian Brothers B.C.C.A.* reviewed with approval the trial judge’s reasoning with regard to the existence of special purpose charitable trusts in the context of ownership of property by charitable associations and by implication by charitable corporations, it did not address the specific question of a charitable corporation’s ownership of its general charitable funds.

can be used. Since the nature of a charitable corporation as a separate legal entity both empowers the charity to carry out its charitable purposes and also allows it to protect the charitable purposes by virtue of the doctrine of *ultra vires* (i.e., that the corporation cannot operate outside of its corporate objects), it would serve no useful purpose at law to require that a charitable corporation hold its property in trust for its general charitable purposes. A charitable corporation, both according to corporate law, as well as in accordance with the equitable jurisdiction of the courts over charitable property, is obligated to ensure that an unrestricted gift to the charity is only used within the parameters of the corporate objects of the charity.¹⁸

A charitable unincorporated association, on the other hand, has on its face more in common with a charitable purpose trust, although they are not exactly the same. Since a charitable unincorporated association is not a separate legal entity, its property, by necessity, must be held in trust by trustees. However, the fact that property is held by the trustees of an unincorporated charitable Association is due to its inability to own property itself, rather than because an unincorporated association is holding its unrestricted property in trust for its charitable purposes. Having said that, the property that is held in trust for an unincorporated charitable association, is, by virtue of the trust relationship, a charitable purpose trust. It is interesting, therefore, that a charity organized as a charitable unincorporated association would generally have its property held as a charitable purpose trust but if it becomes incorporated, it no longer does. This is an interesting dichotomy that does not yet appear to have been addressed by the courts.

With regard to a charitable corporation, even though the corporation can own its general property without the imposition of a trust, once a donor imposes restrictions on a gift whereby the charity is unable to use the gift for the full range of its charitable objects, then the gift will be held as a separate special purpose charitable trust with all aspects of a charitable purpose trust having application to the donor-restricted gift. It in essence becomes a charity within a charity. This unique nature of a special purpose charitable trust is discussed further under “Are Special Purpose Charitable Trusts Recognized in Canadian Law?” below.

¹⁸ *Christian Brothers Gen. Div.*, *supra* note 11 at 392, concurred with in *Christian Brothers Ont. C.A.*, *ibid.* at 702.

To the extent that special purpose charitable trusts and other types of donor restricted charitable gifts are dealt with in a similar manner by a charity no matter how the charity is organized, whether it be in the form of a charitable corporation, an unincorporated charitable association, or a charitable purpose trust, references in the balance of this article to “charity” are intended to include all legal forms through which charities operate. In this regard, *Waters* makes the following observations:

As Snell¹⁹ points out, “the question, strictly speaking, is not whether a ‘charity’ exists, but whether the trusts in which property is held are trusts for charitable purpose”. To which might be added, “or whether the objects of a corporation are charitable.”²⁰

D. WHAT IS THE DIFFERENCE BETWEEN UNRESTRICTED AND DONOR-RESTRICTED CHARITABLE GIFTS?

1. Unrestricted Charitable Gifts

a) What Is the Nature of an Unrestricted Charitable Gift?

An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose, (whether the charitable purpose is in the form of a charitable purpose trust, a charitable corporation, or a charitable unincorporated association), that is not subject to any restrictions imposed either directly or indirectly by the donor, other than the legal requirement that the gift be used for the charitable purpose of the recipient charity. As a result, the board of a charity is at liberty to apply an unrestricted gift to its charitable purposes as stated in its constating documents without restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would fetter or limit the discretion of the board in applying the gift in whatever manner it deemed to be most appropriate to achieve its charitable purpose.

This means that, provided the board of a charity does not exceed its charitable purposes, whether through breach of a fiduciary duty with regard to the general trustee-like obligations in dealing with its charitable property or embarking on *ultra vires* activities that are beyond the objects of the corporation, the charity may use the gift at its absolute discretion. This may involve disbursing all or a portion of the gift, or investing the gift either over the short term or in perpetuity and using the income to pursue any one of the authorized charitable purposes within the constating

¹⁹ Snell, *Principles of Equity*, 28th ed. (1982) at 145.

²⁰ *Supra* note 8 at 503.

documents of the charity. In addition, if the board of a charity decides to designate unrestricted charitable gifts for a specific charitable purpose, there is nothing to stop the board from subsequently undesignating the funds and applying the funds to another charitable purpose within its charitable objects.

b) What Are Some Examples of Unrestricted Charitable Gifts?

Unrestricted charitable gifts form a broader category of gifts than do donor-restricted charitable gifts, since unrestricted charitable gifts include all sources of monies gifted to a charity that are not subject to donor restrictions. The following are some examples of unrestricted charitable gifts:

- government grants that are not restricted to a particular program;
- sponsorship monies received without restrictions;
- unrestricted charitable gifts from donors, either while the donor is alive or through a testamentary instrument, that are directed to be used for the general purposes of the charity, or alternatively where there are no references to restrictions, conditions, limitations or restrictions in the gift;
- board-designated funds consisting of unrestricted charitable gifts that have been designated by the board for a particular purpose or held as a board-initiated endowment fund.

With all of the above funds, and in particular in relation to board-designated funds, it is open to the board to vary, change, or terminate the restrictions or purposes for which those funds have been applied in any other manner that the board thinks is best to achieve the charitable purposes of the charity, without the board being in breach of trust.

2. Donor-Restricted Charitable Gifts

a) What Is the Nature of a Donor-Restricted Charitable Gift?

Black's Law Dictionary defines the term “restrict” or “restriction” to mean: “To restrain within bounds; to limit; to confine”.²¹

²¹ *Supra note 4, s.v. “restrict” and “restriction.”*

For purposes of comparing donor-restricted and unrestricted charitable gifts, “*donor-restricted charitable gift*” in this article means a gift at law to a charitable purpose that is subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would constrain or limit a charity concerning how the gift can be used.

As a result, the board of a charity that receives a donor-restricted charitable gift needs to be careful to identify the nature of the donor restriction and to recognize the legal consequences of the specific type of restriction that has been imposed by the donor, as well as the importance of complying with the restrictions in question.

Too frequently, charities fail to either identify or adequately understand the nature of the donor restriction that has been imposed. This, in turn, exposes charities and their boards of directors to unnecessary and potentially serious liability.

b) Different Forms of Legal Restrictions

The different forms of legal restriction that donors may impose often have distinctive legal consequences associated with them. As a result, it is important to understand both the various forms that donor restrictions may take and the legal consequences that flow from each type.

E. WHAT ARE THE GENERAL FORMS OF DONOR-RESTRICTED CHARITABLE GIFTS?

1. Special Purpose Charitable Trusts

a) What Is the Nature of a Special Purpose Charitable Trust?

A special purpose charitable trust is a gift held by a charity in trust for a specific charitable purpose that falls within the parameters of the general charitable purpose of the charity as set out in its constating documents. The board would be acting *ultra vires* if it were to authorize the corporation to hold property as a special purpose charitable trust where the special charitable purpose was outside the scope of the charity’s corporate objects:

Corporations established by a statute or otherwise for particular purposes which have no existence for any purposes outside those for which they were

created cannot be trustees of charitable trusts for purposes other than those for which they were established.²²

In this regard, while unrestricted charitable gifts are beneficially owned by a charity for its general charitable purposes, gifts that are contributed to a special purpose charitable trust are held by the charity in trust for the stated special purpose and are not owned beneficially by the charity.²³ The charity is, in effect, managing a separate and specific charitable purpose trust within the confines of its own general charitable purpose, i.e., a charity within a charity, except that a special purpose charitable trust is not required to be registered by Canada Revenue Agency (CRA) as a separate charitable organization or charitable foundation.

To the extent that a gift constitutes a separate charitable purpose trust, the charity can only use the gift to accomplish the specific charitable purpose established by the donor and for no other purpose.

The residue of the estate of the testatrix is given on a valid charitable trust. It is clear that it can never be used for any purpose other than the charitable one to which it is devoted.²⁴ [emphasis added]

Special purpose charitable trusts are commonly referred to as “donor-restricted trust funds”, “charitable trust property”, “special purpose funds”, “endowment funds” and “restricted funds”. The general terminology that will be used in this paper is “*special purpose charitable trusts*”, although reference is made to other terminology where the context warrants.

- b) Are Special Purpose Charitable Trusts Recognized In Canadian Law?
 - i) Common Law Recognition of Special Purpose Charitable Trusts

There is a long line of case law, as well as commentaries, that recognize the existence of a special purpose charitable trust as being distinct from the general charitable purpose of the charity which administers it. In this regard, *Tudor on Charities*,²⁵ which was quoted with approval by the Court of Appeal in *Christian Brothers Ont. C.A.*, makes the following

²² *Tudor on Charities*, 8th ed., Jean Warburton and Deborah Morris (London: Sweet & Maxwell, 1995) at 191.

²³ See the next section of this article for a more detailed discussion of this principle.

²⁴ *Guaranty Trust Company of Canada v. Minister of National Revenue*, [1967] S.C.R. 133 at 138.

²⁵ *Supra* note 22.

statement about special purpose charitable trusts in comparison to unrestricted gifts received beneficially by a charity without the imposition of a trust:

A gift to a charitable company is usually construed as a gift to the body beneficially. The Court's approach was set out by Buckley J. in *Re Vernon's Will Trusts*:

There is no need in such a case to infer a trust for any particular purpose. The objects to which the corporate body can properly apply its funds may be restricted by its constitution, but this does not necessitate inferring as a matter of construction of the testator's will a direction that the bequest is to be held in trust for those purposes:

The natural construction is that the bequest is made to the corporate body as part of its general funds, that is to say, beneficially, and without the imposition of a trust.²⁶

and

A charitable company may hold particular property, distinct from the general property of the company, on trust for a specific charitable purpose.²⁷ [emphasis added]

In the *Christian Brothers B.C.S.C.* decision, the facts of which are described below, Levine J. concluded, after reviewing extensive supporting case law, that:

A charitable corporation, such as C.B.I.C. generally holds property absolutely to be used for its charitable purposes, but may hold property as trustee for a specific charitable purpose.²⁸

Levine J. relied upon a number of cases in support of this conclusion, including *Re Ulverston & District New Hospital Building Fund*,²⁹ *Attorney-General for Queensland v. Cathedral Church of Brisbane*,³⁰ *Re Young Women's Christian Association Extension Campaign Fund*,

²⁶ *Ibid.* at 159; see also *Vernon's Will Trusts (Re)*, [1971] 3 All E.R. 1061 (Ch.).

²⁷ *Ibid.* at 191.

²⁸ *Christian Brothers B.C.S.C.*, *supra* note 11 at 112.

²⁹ *Ulverston & District New Hospital Building Fund (Re)*, [1956] 3 All E.R. 164 at 168–169 (C.A.).

³⁰ *Attorney-General for Queensland v. Cathedral Church of Brisbane* (1977), 136 C.L.R. 353 at 371 (H.C. of A.).

³¹Re Church Army,³² Re Lucas,³³ Re Finger's Will Trust.³⁴ After reviewing these authorities, but without dealing with the separate issue of what impact a special purpose charitable trust has on the issue of exigibility of the assets (which is discussed later in this article), Levine J. concluded that special purpose charitable trusts are in fact recognized in Canadian law:

Although the Ontario Court of Appeal disagreed with Blair J.'s conclusions about the effect of a "specific charitable purpose trust" on immunity, it did not say that such a trust does not exist in law, as argued by the liquidator.... Thus, contrary to the position taken by the liquidator, the cases which consider whether a special purpose trust has been created by a will for the purpose of determining whether the gift is valid or void do have application to the question in issue here: whether a special purpose trust was created by *inter vivos* gifts to a charitable organization. All the circumstances of the making of the gift must be reviewed to determine its terms and effect."³⁵

She further stated that:

A corporation cannot hold property on trust for a non-charitable purpose, as such a trust would be void for uncertainty of objects or as offending the rule against perpetual duration. A corporation can, however, hold property as a trustee for a charitable purpose, where "there are circumstances which show that the recipient is to take the gift as a trustee." (*Re Vernon's Will Trusts* at p. 303.)³⁶

Hollinrake J.A. of the British Columbia Court of Appeal approved of Levine J.'s analysis on this issue in his decision in *Christian Brothers B.C.C.A.*,³⁷ thus confirming that a special purpose charitable trust exists in Canadian law. Although not referred to by Levine J. or by Hollinrake J.A., support for this conclusion can be found in the decision of *Re Bucks Constabulary Widows' and Orphans' Fund Friendly Society*,³⁸ in which the Court commented as follows:

³¹ *Young Women's Christian Association Extension Campaign Fund (Re)*, [1934] 3 W.W.R. 49 at 52 (Sask. K.B.).

³² *Church Army (Re)* (1906), 94 L.T. 599 (C.A.).

³³ *Lucas (Re)*, [1948] 2 All E.R. 22 at 25–26 (C.A.).

³⁴ *Finger's Will Trusts (Re)*, [1972] Ch. 286 at 294–295.

³⁵ *Christian Brothers B.C.S.C.*, *supra* note 11 at 106–107.

³⁶ *Ibid.* at 111.

³⁷ *Christian Brothers B.C.C.A.*, *supra* note 11 at 273–275.

³⁸ *Bucks Constabulary Widows' and Orphans' Fund Friendly Society (Re)*, [1979] 1 All E.R. 623 (Ch.D.).

All the assets of the association are held in trust for its members (of course subject to the contractual claims of anybody having a valid contract with the association) *save and except to the extent which valid trust have otherwise been declared of its property.*³⁹ [emphasis added]

It is also interesting to note that the Ontario Legislature has acknowledged that funds can be held for a specific charitable purpose separate from the general charitable funds of a charity as a result of amendments to the *Charities Accounting Act* of Ontario,⁴⁰ set out below, that authorize regulations to be adopted permitting the commingling of various funds held for different special purposes:

The Attorney General, on the advice of the Public Guardian and Trustee, may make regulations providing that acts or omissions that would otherwise require the approval of the Ontario Court (General Division) in the exercise of its inherent jurisdiction in charitable matters shall be treated, for all purposes, as though the acts or omissions had been so approved ... (2) [in relation to] ... (b) the administration and management of charitable property that is held for restricted or special purposes.

ii) The Position That Special Purpose Charitable Trusts Are No Longer Recognized in Canadian Law

The position that special purpose charitable trusts may no longer be recognized in Canadian law arises from comments made by Feldman J.A. in *Christian Brothers Ont. C.A.* In order to understand those comments, it is first necessary to understand the facts behind the *Christian Brothers* case and the series of decisions that have been rendered in the case.

The background facts involving the *Christian Brothers* case have been well summarized in the decision of Levine J. in *Christian Brothers B.C.S.C.*, the highlights of which are set out below:⁴¹

- Christian Brothers is a worldwide Roman Catholic teaching order which has had a presence in North America since 1876 when the Christian Brothers came to Newfoundland to teach Roman Catholic youth.

³⁹ *Ibid.* at 626 (per Walton J.)

⁴⁰ *Supra* note 12.

⁴¹ *Christian Brothers B.C.S.C.*, *supra* note 11 at 95–98.

- In 1898, the Christian Brothers opened the Mount Cashel School, an orphanage for boys in St. John's, Newfoundland.
- In 1922, the Christian Brothers opened and operated Vancouver College in Vancouver, British Columbia.
- In 1960, the Christian Brothers agreed to establish and operate St. Thomas More Collegiate in Burnaby, B.C.
- In 1962, the Christian Brothers were incorporated by a Special Act of Parliament.
- In 1989, the Newfoundland Government appointed a Royal Commission to enquire into allegations made by boys who had been residents at Mount Cashel Orphanage that they had been sexually, physically and emotionally abused by members of the Christian Brothers. The findings of the Commission resulted in criminal charges and numerous civil actions for damages for abuse
- By July 1999, the aggregate amount claimed from the Christian Brothers was approximately \$67,000,000.
- By 1996, the Christian Brothers realized that the claims for damages far exceeded their general corporate assets that amount to no more than \$4,000,000. They therefore made application to be wound up under the Winding-Up and Restructuring Act.⁴² Christian Brothers was subsequently ordered to be wound-up and a liquidator was appointed.
- In July of 1997, the liquidator asked the winding-up court for advice and direction on legal questions relating to whether charities or their assets were immune from liability or were eligible to satisfy tort claims. The winding up court directed that those questions be heard by a judge of that court.
- In November 1997, Blair J. ordered that the nature and scope of any trusts involving property located in British Columbia would be dealt with by the courts in British Columbia.

⁴² *Winding-Up and Restructuring Act*, R.S.C. 1985, c. W-11.

- The resulting B.C. decision of Levine J. in *Christian Brothers B.C.S.C.* held that the two schools located in British Columbia were held by the Christian Brothers as special purpose charitable trusts.
- In *Christian Brothers B.C.C.A.*, the B.C. Court of Appeal affirmed Levine J.'s decision.
- In relation to the issue of exigibility of special purpose charitable trusts, discussed in more detail later, Blair J. in *Christian Brothers Gen. Div.* held that the general corporate property of a charity is not immune from exigibility by tort creditors; however, property held as a special purpose charitable trust by a charity would not be available to compensate tort creditors of the charity unless the claims arose from a wrong perpetrated within the framework of the particular special purpose charitable trust in question.
- In *Christian Brothers Ont. C.A.*, Feldman J.A. agreed with Blair J. that there is no general doctrine of charitable immunity applicable in Canada; however, she held that once Blair J. had determined that there was no doctrine of charitable immunity in Canada, it then became redundant for the court to analyze whether special purpose charitable trusts of a charity were exigible to pay the claims of tort creditors. As a result, the Ontario Court of Appeal held that all assets of a charity, whether they are owned beneficially or they are held pursuant to a special purpose charitable trust, are available to satisfy claims by tort victims upon the winding-up of the charity.⁴³
- The British Columbia courts did not decide the issue of exigibility, which they held was not a question that was open to them to determine. However, in his dissenting opinion in the Court of Appeal, Braidwood J.A. took the position that this issue was open to the court to decide, essentially agreeing with Blair J. on this issue.

Even though the Ontario Court of Appeal held that special purpose charitable trusts are not immune from claims by tort victims, Feldman J.A. went to considerable lengths to confirm that charities can still hold specific property pursuant to a special purpose charitable trust and that a charity and its directors must hold and deal with such assets as charitable trust property, including the obligation to seek judicial variation of a special purpose trust through

⁴³ For a more detailed discussion of the Ontario Court of Appeal decision in *Christian Brothers, Ont. C.A.*, see David Stevens, "Exigibility of Special Purpose Charitable Trusts: The Christian Brothers Ontario Court of Appeal and British Columbia Supreme Court Decisions". (Paper presented at Canadian Bar Association of Ontario, First Annual Charity Law Symposium *Fundamental New Developments in the Law of Charities* 2000 (Toronto)) [unpublished].

a *cy-près* court order where the applicable charitable purpose has become impossible or impracticable. In this regard, Feldman J.A. stated:

The authors of *Tudor on Charities* 8th ed. (1995), p. 59, have extrapolated from this law the proposition that a charitable company may hold particular property in trust for specific charitable purposes, distinct from its other property, and that “clearly to misapply said property would be a breach of trust”. I agree with the authors of *Tudor on Charities* as to the obligations that charity would accept with such gifts, but subject to the following qualifications:

- (a) as long as the charity is in operation; and
- (b) subject to any *cy-près* order of the court, that the charity will be obligated to use the funds for the purposes stipulated by the trust⁴⁴

Having recognized special purpose charitable trusts, Feldman J.A. had to distinguish between property held as a charitable purpose trust and property held pursuant to a private trust where the trust property is protected from claims against the trustee personally in order for the assets of a special purpose charitable trust to be seized by tort claimants of the charity. In order to do this, Feldman J.A. went through a process of removing so many attributes of a special purpose charitable trust that it ends up being a trust in name only and imposes, at most, “trustee-like” obligations upon a charity concerning how it uses such “trust” property. This judicial erosion of the special purpose charitable trust as a legal trust is evident in the following statement by Feldman J.A. concerning the effect of a special purpose trust:

To the extent that charitable corporations do accept donations in trust for one of their charitable purposes, as opposed to in the form of a precatory trust, or a non-trust agreement governing the conditions and use of the gift, the trust obliges the charity to use the donation only for the specific objects of the trust while the charity is operating, again subject to any court order that may be sought for *cy-près* if while the charity itself continues to operate, that purpose or object becomes impossible or impracticable to continue. If the charity, while still operating, determined that it was in the best interests of the charity to use the assets held on special purpose trust instead of other assets to pay tort claims, that may be a situation where the charity would seek the approval of the court for the scheme, if the

⁴⁴ *Christian Brothers Ont. C.A.*, *supra* note 11 at 704.

consequence would be that the particular purpose would no longer be carried out by the charity. When a corporation is wound up, the “business” of the corporation ceases. . . . Where the corporation is a charity, this means that the charity ceases to carry out its charitable purposes. The obligation of the charity to use assets held on trust for one or more of the trust purposes also ceases as it may no longer carry on.⁴⁵

What is evident from the decision of Feldman J.A. of the Court of Appeal is that in deciding, as a matter of policy, to make the property of a special purpose charitable trust exigible to tort creditors of the charity, Feldman J.A. ignores the fact that a special purpose charitable trust is in fact a true trust at law, instead of the charity holding property in trust for itself in a trustee-like capacity.

If the beneficiary of a special purpose charitable trust were the charity itself, it would be understandable that the Court of Appeal would find that the property of a special purpose charitable trust would be available to satisfy the claims of tort creditors of the charity. However, fundamental to the concept of a special purpose charitable trust is that the usual requirement that there be an identifiable beneficiary of a trust is not applicable to a charitable purpose trust. This is one of the basic attributes of what constitutes a charitable purpose trust. A charitable purpose trust is recognized as benefiting the public-at-large instead of a single beneficiary and the purpose is enforceable by the courts as a complete trust in the same way as any private trust is. Since Feldman J.A. recognizes the case authority that special purpose charitable trusts can be held distinct from the general corporate property of a charitable corporation, and since the public-at-large is the beneficiary of such trusts, it then follows that a special purpose charitable trust is as much a trust at law as a private trust with all of the attributes associated with a trust, including protection of trust property from creditors of the trustee personally.

The impact of Feldman J.A.’s decision on the separate issue of exigibility of special purpose charitable trusts is discussed later in this article.

⁴⁵ *Ibid.* at 708–709.

c) The Requirements For the Creation of a Special Purpose Charitable Trust

Both traditionally and in practice, a special purpose charitable trust is considered to have been established when the donor has expressed an intention that the property being given to the charity is to be held for a specific charitable purpose, e.g., when money has been raised for an endowment program or through a public fundraising appeal for a specific project. However, the opposing approaches taken in the *Christian Brothers Gen Div.* decision of Blair J. and the *Christian Brothers B.C.S.C.* decision of Levine J. have raised a number of important issues concerning what type of evidence will be required to establish that the donor had the necessary intent to create a special purpose charitable trust. Blair J. held that there is a higher, more formal standard that is required, whereas Levine J. determined that the applicable requirements are less formal and can involve consideration of all relevant circumstances involved in making the gift.

Certain observations can be made regarding the differences in approach taken in the two decisions. In determining what is required to establish the intention of a donor to create a special purpose charitable trust, Blair J. in *Christian Brothers Gen. Div.* distinguished between what he considered to be a “true” [whatever that means] charitable purpose trust and gifts or bequests that are simply “earmarked” for some specific charitable purpose and are not, in fact, trusts at all. He stated that before there can be a “true” charitable purpose trust, the trust must first be established in accordance with the general formal requirements of trust law:

For a “trust” to come into existence, there must be a settlor, a trustee, trust property and trust objects (i.e., person beneficiaries or charitable purposes). The arrangement must be characterized by the “three certainties” – which are considered essential to the creation of a trust – namely certainty of intention, certainty of subject matter, and certainty of objects...: [See Waters, *supra* note 8, at 107]. It must be clear that the settlor intended to create a trust, it must be clear exactly what assets are to form the trust property, and the beneficiaries (the objects) of the trust must be ascertained or ascertainable. If the purpose is “charitable” – i.e., for the relief of poverty, the advancement of education, the advancement of religion, or for other purposes beneficial to the community – and the foregoing criteria met, a charitable purpose trust is established.⁴⁶

In addition to requiring the formalities of trust law, Blair J. confirmed that all gifts received by a charity are presumed to have been received by it beneficially for its general charitable purposes,

⁴⁶ *Christian Brothers Gen. Div.*, *supra* note 11 at 397.

unless there is evidence that gives rise to the creation of a special purpose charitable trust, i.e., where it was created in accordance with the formalities referred to above:

Nor is there any presumption that the assets of The Christian Brothers of Ireland in Canada, as a charitable corporation, have been received in trust or in a trust-like capacity, to be used only for the charitable purposes of the corporation. In law, the presumption is to the contrary. That is, the assets of the corporation are presumed to have been received by it beneficially and for its absolute use – albeit in accordance with the objects of the corporation, as required by corporation law – unless there is some evidence to give rise to the creation of a trust.⁴⁷

Given the formalities that Blair J. requires for the creation of a special purpose charitable trust and the fact that the law generally presumes gifts received by a charitable corporation to have been received beneficially and not held in trust, Blair J. describes gifts where donors have not formally expressed an intention sufficient to create a special purpose charitable trust to be a “precatory trust” only, i.e., only a suggested designation by the donor and not a “true” special purpose trust. He mentions, as an example of a gift that in his opinion might be a “precatory trust” gift, contributions that are raised through a public fundraising campaign for a specific building project of a charity:

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 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 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. The asset is therefore exigible on the rationale explained above with respect to contributions made to a charitable corporation for its general charitable purposes.⁴⁸

Property emanating from contributions made through general fund-raising campaigns – or even through fund-raising campaigns for particular projects —

⁴⁷ *Ibid.* at 409.

⁴⁸ *Ibid.* at 396.

as, for example, the fund-raising campaign for the establishment of the Novitiate in Mono Mills – might fall into this category.⁴⁹ [emphasis added]

If this position were to prevail, it would be open for a charity to argue that a gift that a donor had thought was a restricted gift in the form of a binding special purpose charitable trust was really only a precatory trust that amounted at most to a moral obligation upon the charity but was not the imposition of a legal requirement. This would create a great deal of uncertainty for charities in general and for donors in particular.

However, the approach taken by Levine J. in *Christian Brothers B.C.S.C.* ignores the formalities required by Blair J., and instead adopts a more traditional approach concerning what is required to create a special purpose charitable trust. After citing Waters concerning the need for “certainty of intention” as one of the three requirements for a special purpose charitable trust, Levine J. states that the required intention to create a charitable purpose trust is not dependent upon the utilization of technical words such as “in trust,” or otherwise, but rather requires that the court look at all of the relevant circumstances to determine the real intention of the donor. In this regard, Levine J. quotes with approval the following statement from Waters:

*There is no need for any technical word or expressions for the creation of a trust. Equity is concerned with discovering the intention to create a trust; provided it can be established that the transferor had such an intention, a trust is set up.*⁵⁰ [emphasis added]

In finding that the schools located in British Columbia were held as special purpose charitable trusts by the Christian Brothers, Levine J. had to deal with the fact that there was no clear statement of intention to this effect. In support of the finding that there was sufficient evidence to establish a special purpose charitable trust, she relied upon the following statement from *Smith v. Kerr*:

⁴⁹ *Ibid.* at 397.

⁵⁰ *Supra* note 8 at 107.

It is true that the word “trust” is not found, but that word is not necessary, if upon the fair construction of the whole document it is manifest that a trust or duty or obligation was intended.⁵¹

Levine J. went on to make the following observations concerning what is required to establish satisfactory evidence of an intent by a donor to create a special purpose charitable trust:

Where there is no trust document, the court will consider other evidence to determine the intention of the settlor, including contemporaneous documents and usage, the circumstances surrounding the execution of any trust document, the donor’s contemporaneous acts, the early application or distribution of the funds and the construction placed on doubtful questions which arose in the early administration of the trust...evidence of the use of property by the trustees over a long period of time may assist in determining the intention of the settlor.⁵²

The approach taken by Levine J. is a less radical departure than that of Blair J., as it is a return to the more settled approach in determining what is required to create a special purpose charitable trust. However, even if the position taken by Blair J. were to be followed in the future and a donor-restricted gift lacked the formalities to be considered a special purpose charitable gift, the charity would still be subject to the statutory jurisdiction of the Public Guardian and Trustee of Ontario in being able to seek an order to enforce a “donor direction” under s.4(d) of the *Charities Accounting Act*. A further discussion concerning the effect of this provision of the *Charities Accounting Act* is set out later in this article.

From a practical standpoint, though, Blair J.’s decision would mean that any donors who have assumed that their restricted gifts are enforceable against the charity would be surprised to find that if they had not clearly established their gift as a formal “true” special purpose trust, it might be arguable that the receipting charity would be able to apply the gift for any of its general charitable purposes, as opposed to using the gift only in accordance with the restrictions that the donor had intended.

Although this may be good news for those charities that feel unduly constrained by restrictions imposed by donors, there would also be a corresponding erosion of confidence by donors who, in

⁵¹ *Smith v. Kerr*, [1900] 2 Ch. 511 at 522.

⁵² *Christian Brothers B.C.S.C.*, *supra* note 11 at 107–108.

the past, have assumed that their gifts constituted binding donor-restricted special purpose charitable trusts that could not be altered by either the current or future boards of a charity. This confidence was predicated on the willingness of the courts, particularly in England, to find an implied special purpose charitable trust even where the donor's intention was not patently obvious. (This judicial willingness is discussed later in this article.) However, Blair J.'s decision, if followed, would indicate a leaning by the courts against finding an implied special purpose charitable trust. If this trend is followed, it could discourage donors from making restricted charitable gifts and, in turn, could be a problem for charities such as community foundations, which rely heavily upon, and encourage donor-restricted charitable gifts, particularly in the form of endowment funds.

In *Christian Brothers B.C.C.A.* Hollinrake J.A. essentially adopted the reasoning of Levine J. in *Christian Brothers B.C.S.C.* with little analysis or explanation. In this respect, the decision in *Christian Brothers B.C.C.A.* is unsatisfactory as it leaves the dichotomy between the approaches taken by Blair J. and Levine J. unresolved.⁵³ Moreover, since leave to appeal to the Supreme Court of Canada has been denied in both the Ontario and B.C. cases,⁵⁴ this question is not likely to be resolved soon.

Until further guidance is available on this matter, it would therefore be prudent for charities, donors, and their legal counsel to be careful in ensuring that the formalities required for the creation of a trust are clearly articulated in the document creating a restricted gift, whether it be through an *inter vivos* endowment agreement or by means of a testamentary gift. Specifically, it would be important to clearly categorize the gift as being a special purpose charitable trust by naming the charity as the trustee, describing the property that constitutes the gift to be held in trust by using the words "in trust", and explaining the specific charitable purpose for which the property is to be used. Failure to do so by lawyers who are instructed to establish restricted gifts or endowments may become the basis of a claim in negligence for not ensuring that the intent of the

⁵³ The recent case of *Ukrainian Youth Assn. of Canada v. Galandiuk* (2001), 43 E.T.R. (2d) 317 (Ont. Sup. Ct.) follows the approach of Levine J. in *Christian Brothers B.C.S.C.* However, the decision simply adopts the test with no discussion or explanation and it is therefore not particularly helpful in providing insight with respect to the direction which other courts are likely to take on this issue.

⁵⁴ *Christian Brothers of Ireland in Canada (Re)*, [2000] S.C.C.A. No. 277; *Rowland v. Vancouver College Ltd.*, [2001] S.C.C.A. No. 652.

donor had been adequately expressed to create a binding special purpose charitable trust capable of effectively restricting the charity in the future.

In relation to existing endowment agreements, the wording should also be carefully reviewed and a legal opinion sought to determine whether or not the wording was sufficient to create a special purpose charitable trust in light of Blair J.'s decision in *Christian Brothers Gen. Div.* In addition, the wording of standard disposition clauses that are suggested by charities to estate practitioners for use in creating donor-restricted charitable gifts in wills, should also be reviewed.

Since it is not known whether the approach of Blair J. or the approach of Levine J. will prevail, the balance of this article has been prepared to reflect both the cautious approach that should be adopted in the event that Blair J.'s reasoning is followed, while at the same time recognizing that case law supports the broader interpretation reflected in Levine J.'s reasoning that looks at all of the relevant circumstances, instead of only what is in writing, in determining the intention of the donor.

d) Endowment Funds

i) What Is the Nature of An Endowment Fund?

An endowment fund is generally considered to be a special purpose charitable trust through which the donor requires that the capital of the gift be held in perpetuity. Since one of the advantages of a charitable purpose trust is the exemption from the rule against indestructible trusts, a charity is able to accept gifts where the capital is held in trust on a perpetual basis. This method of charitable funding is not available to a nonprofit organization, since a nonprofit organization does not constitute a charitable purpose trust at law.

ii) How Is the Capital In An Endowment Fund To Be Invested?

The capital in an endowment fund is to be invested in accordance with either the investment terms contained in the document creating the endowment fund or in accordance with the investment powers of the charity set out in its constating documents. Whether or not a portion of the income that is earned from an investment will be capitalized and reinvested will depend upon either the terms in the endowment agreement or the investment policy established by the board of the charity in accordance with its investment powers. Unless the

terms of the endowment require that all of the earned income is to be disbursed, it is normal for the board to provide that a portion of the income is to be reinvested so that the capital of the endowment fund will at least keep up with inflation and will preferably increase on a net basis over the years.

iii) For What Purpose Can Income Earned On An Endowment Fund Be Used?

How the income earned on an endowment fund is applied depends upon whether the donor has expressed a specific direction concerning disbursement of income in the endowment agreement or alternatively whether the board has established terms of reference concerning how endowment income is to be applied. In either scenario, the board must ensure that the income is applied only towards the charitable purposes of the charity. To the extent that the donor has not established restrictions concerning how the income from the endowment fund is to be used, the board of a charity will be at liberty to apply the income to any of its charitable purposes, as determined by the board from time to time.

iv) How Are Endowment Funds Created?

There are three ways in which endowment funds can be created: by the board, by the donor, or by a combination of the two. When the endowment fund is initiated by the donor, it will normally involve the donor leaving money through a testamentary gift in perpetuity or, alternatively, creating an endowment fund by means of an endowment agreement. If an endowment agreement is employed, whether it be one supplied by the charity or one drafted by the donor's legal counsel, issues such as investment and management of the endowment fund, the name of the endowment fund, as well as disbursement of the income from the endowment fund will normally be addressed.

When the board of a charity takes steps to create an endowment fund, it usually announces that a named endowment fund has been established and invites donors to contribute to it. The board in this situation will establish the terms of reference for the endowment fund, i.e., how the income will be disbursed and how the capital fund will be invested. If it is a board-initiated endowment fund, it will normally have a descriptive name associated with it, such as "The Education Fund", or "The Millennium Fund", so that prospective donors can identify it when making a contribution.

In the third type of endowment fund, the board invites donors to establish individual endowment funds with the charity. This allows the donor, (within the parameters of the charitable purposes of the charity) to structure the endowment fund personally. This type of endowment fund is often encountered in community foundations and may involve the donor being able to name the endowment fund and permit family members and friends to make additional contributions of capital from time to time.

To the extent that the board of a charity contributes any of its unrestricted charitable funds to an endowment fund, those contributions can be re-designated by the board at any time towards any of its other charitable purposes. However, any monies that are contributed by donors to either a board-initiated endowment fund or a fund that is initiated by the donor in accordance with the formal requirements of a special purpose trust cannot be varied by either the board or the donor without court approval. (This issue is discussed in more detail later in this article.)

e) Donor Restricted-Use Funds

i) What Is the Nature of Donor Restricted-Use Funds?

Unlike endowment funds, donor restricted-use funds do not require that the capital of a gift be held in trust. Instead, the capital, as well as earned income will be expended over a period of time rather than being held in perpetuity and may be applied in accordance with certain specific charitable purpose restrictions. Unlike endowment funds where the restriction on the use of capital will continue in perpetuity, a donor restricted-use fund involves restrictions that eventually will be fulfilled, thereby bringing the fund to an end.

ii) Time Restrictions

Some restrictions that are imposed by donors involve either a delay in when a gift can be used, i.e., until a specified date, or a requirement that the gift be expended over a specific number of years. In either situation, the time restriction will eventually expire when the capital and any accrued income have been fully expended.

iii) Purpose Restrictions

Donors may also impose purpose restrictions concerning how a gift will be applied to further a particular capital purpose such as a building program, or an operational purpose, such as a relief effort in a foreign country. In either situation, it is essential that the purpose restrictions established be within the parameters of the charitable purpose set out in the charity's constating documents. If this is not the case, then the board of the charity will either be in breach of trust if it is a charitable trust, or liable for having authorized *ultra vires* activities outside of the corporate authority of the charity if it is a corporate charity.

In addition, donors may establish purpose restrictions concerning the manner in which the charitable objects of a charity are to be carried out. For instance, donors may establish restrictions that do not limit what the charity can do, but rather who is entitled to benefit from its activities. In such a situation, it is important that the board ensure that the restrictions are not void as being repugnant or contrary to public policy, such as restrictions that are discriminatory.⁵⁵

iv) How Are Donor Restricted-Use Funds Created?

As with endowment funds, donor-restricted funds can be established at the initiation of the donor either through an *inter-vivos* or testamentary gift that includes a time or a purpose restriction. Alternatively, the board of a charity can take the initiative in establishing a restricted-use fund by inviting donations from supporters or from the public for a specific purpose. Provided that the wording used to establish the donor-restricted fund meets the formal requirements of a trust, the monies received will generally constitute donor-restricted charitable purpose trust funds to be used in furthering a specific charitable purpose, such as a building program for a new church or a new wing for a hospital.

f) Restricted Charitable Trust Property

i) What Is the Nature of Restricted Charitable Trust Property?

Restricted charitable trust property is a term used to describe real estate that is acquired subject to certain terms of trust contained in the deed for the property. Religious charities often receive or acquire property through deeds that set out specific terms of trust which will

⁵⁵ *Supra* note 8 at 262.

continue in perpetuity, even if the land and buildings are sold, by impressing the sale proceeds with the same terms of trust. As a result, it is essential that the board of a charity determine whether or not any of its real property either now or in the past is subject to restricted charitable trusts and, if so, to ensure that the property either was, or is, currently being used in accordance with the applicable restrictions.

ii) Nature Of Restrictions Involving Restricted Charitable Trust Property

Generally, restrictions normally found in deeds containing restricted charitable trusts tend to be of a religious nature and fall into one of three categories:

- restrictions pertaining to religious doctrine, i.e., requiring that the property be used only for individuals who subscribe to a particular religious doctrine;
- restrictions pertaining to use, i.e., limiting the property to a particular use, such as use for a church, cemetery or seminary; and
- restrictions limiting the use of the property to those who follow a particular religious practice, similar to requiring that the property be used only by members of a church who adhere to the practice of “strict communion”, i.e., where the sacrament of communion can only be received by baptized members of a particular denomination.

What is not often understood by a charity, either in receiving a deed to property from a vendor that is made subject to a special purpose trust or in unilaterally imposing a trust at the time that it takes title to the property, is that the trust that is created is a trust in perpetuity which will have permanent implications similar to an endowment fund or to any other special purpose trust fund. Since the charity will not have the ability to unilaterally vary the terms of trust without court authorization, it needs to be both aware of the terms of trust and to ensure that it can either comply with the restrictions or otherwise seek court authorization to vary it. (The legal principles upon which the court will vary the terms of a charitable trust are discussed in more detail later in this article.)

iii) How Are Restricted Charitable Trust Properties Created?

Restricted charitable trust properties are almost invariably created by the inclusion of a specific trust clause in a deed for land. This can occur when a grantor donates property to a

charity and intends the property to be used only for a particular purpose. In such a scenario, the grantor may include a reversionary clause in the deed stipulating that the property is to revert back to the grantor in the event that the terms of the trust are not complied with. When this occurs, it is important to review the specific wording in the deed to determine whether or not a condition subsequent has been created as opposed to a special purpose charitable trust, since different legal implications flow from the distinction. (The differences between a conditional gift and a special purpose charitable trust are discussed later in the article.)

In the other scenario in which a trust clause is included in a deed, the charity itself imposes the terms of trust stating that the property being acquired can be used only for a specific purpose or purposes.⁵⁶ The terms of trust would need to be consistent with the charitable objects of the charity. If not, it would be unlikely that the restricted charitable trust in the deed would be a valid and enforceable special purpose charitable trust.

A more problematic situation arises when monies are given specifically for the construction of a building on a particular piece of land for a particular purpose. The issue is whether the application of the special purpose charitable trust fund to construct a building has the effect of imposing a special purpose charitable trust upon the land itself. This issue was dealt with in the Australian case of *Attorney-General for Queensland v. Cathedral Church of Brisbane*⁵⁷ in which monies were raised through a public fundraising appeal by the Cathedral Church of Brisbane to construct a hospital on lands that the church owned. Although the High Court of Australia had no difficulty in finding that the funds given constituted a special purpose charitable trust, the Court rejected the notion that by accepting public funds for the stated purpose of constructing a hospital, the church had implicitly declared a trust to use the land in question for such purpose:

Clearly, the sum raised by public subscription was held by its recipient on trust to use it in the erection of the hospital. But in my opinion, by accepting the public subscriptions, neither the Synod, by its committee, nor the [church] accepted an obligation to declare a trust of the land on which the hospital should be erected. The undoubted circumstance that a hospital

⁵⁶ *Supra* note 11 at 520.

⁵⁷ *Supra* note 30.

may be a charity in the relevant sense does not require the conclusion that the building of a hospital by the Cathedral created a charitable trust of the land on which it was built.

...but I am unable to conclude that, because the purpose of the public appeal for funds was charitable, the land upon which the building was erected and the building itself became impressed with a charitable trust. My own analysis is, as I have said, that [as] the Cathedral appealed to the public for funds to enable it to build a hospital on its own lands, the lands and the hospital remain in the absolute property of the Cathedral. No trust of land or building was, in my opinion created.⁵⁸

An interesting aspect of this decision is the implicit recognition that once funds given for a special purpose charitable trust have been applied to their intended purpose, such as the construction of a building or a portion of a building, i.e., a wing of a hospital, not only is the land in question not made subject to a special purpose charitable trust, but the special purpose charitable trust of the original gift comes to an end. This means that, contrary to the suggestion by Feldman J.A. in *Christian Brothers Ont. C.A.*, once the subject matter of a special purpose charitable trust has been applied in accordance with the terms of the donor's restriction, i.e., to renovate or enlarge a building, then the trust will be considered to be at an end and the building that has been improved by such funds will continue as the beneficial property of the charity without restrictions. This approach was reflected in the High Court of Australia decision in *Attorney-General of Queensland v. Cathedral Church of Brisbane*:

The further distinction needs to be borne in mind. A trust to a charitable institution such as a church of money or property for the improvement of the fabric of the church or of some other purpose will in many instances be fully performed once the money has been so expended. There is no separate *continuing* trust of the improvement.⁵⁹ [emphasis added]

⁵⁸ *Ibid.* at 358–359.

⁵⁹ *Ibid.* at 372.

iv) What Happens When Property Subject To a Restricted Charitable Trust Is Transferred?

Where land that is subject to a charitable trust is transferred, the proceeds of the sale will remain subject to the terms of trust.⁶⁰ Alternatively, if the property is being sold to a successor (for example, where an unincorporated church incorporates and transfers all of its property to an incorporated church entity), the transferee charitable corporation will take the property subject to the same terms of trust as were set out in the original deed, whether or not the current deed makes reference to those terms of trust.

g) Implied Special Purpose Charitable Trust Funds

i) What Is the Nature Of Implied Special Purpose Charitable Trust Funds?

The word “implied” in an implied special purpose charitable trust fund refers to what is required at law as evidence that the donor in fact intended to create a charitable trust. If the document accompanying a charitable gift clearly states that the gift is to be held in trust and the basic three certainties of a trust are met, the donor will clearly have created an express special purpose charitable trust fund. On the other hand, if the circumstances surrounding the gift or the general language in the document accompanying the gift are sufficient to establish that the donor intended the gift to be held in accordance with a special purpose charitable trust, then the donor would be considered to have established a trust by implied intent.⁶¹

As indicated earlier in this article, Blair J. in *Christian Brothers Gen. Div.* stated that a special purpose charitable trust must be formally established in writing with a settlor, trustee, identifiable trust property and trust objects, preferably using specific terminology indicating that the gift is being given “in trust”. However, there are numerous reported cases, as indicated earlier, particularly from England, where the courts have been prepared to consider extrinsic evidence concerning whether the donor intended to create a special purpose charitable trust and, if so, what the nature of the restrictions that would apply were:

⁶⁰ See *Anglican Diocese of Algoma v. Algoma University* (Ont. Ct. (Gen. Div.)) [unreported] (contact the Office of the Public Guardian and Trustee). In this case, the Diocese had received a grant of land over 100 years ago that included a trust clause stating that the land could only be used for “Indian education”. The Diocese sold off portions of the land, including all of the land on which the University of Algoma is built. In a mortgage action involving the University land, the Public Guardian and Trustee investigated what had happened to the proceeds from the sale of the special purpose trust property and required that the Diocese establish a special purpose trust fund for “Indian education” in an amount equivalent to the sale proceeds of the land together with accrued interest. See also *Christian Brothers Gen. Div.*, *supra* note 11 at 410.

⁶¹ *Supra* note 8 at 18.

If the [donor's] intention is not expressed in the instrument, however, or if the intention is expressed in ambiguous language, extrinsic evidence is admitted. Such evidence may be of the known opinions of the [donor], of the state of law existing at the date when the instrument took effect, or of contemporaneous usage, or the like, and the evidence is admitted to enable the court to determine the objects of the charity in the manner in which the trusts are to be preformed.⁶²

In dealing with this issue at the trial level, the Supreme Court of British Columbia in *Christian Brothers B.C.S.C.* recognized that there was no written declaration of trust by which the two schools in British Columbia had been stated as being held in trust by the Christian Brothers:

Both schools say that the donors of the funds used to establish the school intended to create a trust of the funds for the specific charitable purpose of the operation of the school. There is no trust document in the case of either school expressly setting out the intentions of the donors to create such a trust, so the school is relying on the type of evidence described above.⁶³ [i.e., extrinsic evidence, such as contemporaneous acts and the early administration of the trust.]

After thoroughly reviewing all of the circumstances, in lieu of a formal declaration of trust, Levine J. concluded that there was sufficient evidence to conclude that there was an implied special purpose trust fund.

At the outset, I find the evidence is overwhelming that in the case of both schools, the intentions of all of the parties (that is, the identifiable donors of funds, the Archbishop and his representatives and the representatives of the congregation) were to establish the schools and not to further the general charitable objects of the congregation. That is, none of those involved in establishing and operating the schools had any intention or took any steps to provide for the congregation to use the schools' property for any purpose other than to operate schools for the use of the communities they were established to serve.⁶⁴

⁶² *Supra* note 22 at 168, 169 and 179.

⁶³ *Christian Brothers B.C.S.C.*, *supra* note 11 at 108.

⁶⁴ *Ibid.* at para. 262.

ii) What Are Examples Of Implied Special Purpose Charitable Trust Funds?

Instances where an implied special purpose charitable trust fund might be found, presuming that the reasoning of Levine J. in *Christian Brothers B.C.S.C.* prevails over that of Blair J. in *Christian Brothers Gen. Div.*, would include the following:

- A public fundraising campaign for a specific purpose, whether it be a capital endowment fund or a building project.⁶⁵
- A donor who gives money to a charity with no accompanying written documentation setting out his or her intentions. However, in discussions with the development officer for the charity and in preliminary correspondence between the donor and the development officer, there is clear reference made to the fact that the gift is to be held in perpetuity as an endowment fund for a particular purpose, i.e., to fund a professorship at a university.
- Most donors making a gift to a parallel foundation, such as a hospital foundation, assume that the gift will be used to benefit the parallel operating charity, particularly when the names of the parallel foundation and the parallel operating charity are virtually identical, i.e., the “ABC Hospital” and the “ABC Hospital Foundation”. However, some foundations have charitable objects that permit the board of directors of the foundation to use the monies received by the foundation for purposes other than benefiting the parallel operating charity. Notwithstanding the doctrine of constructive notice,⁶⁶ (which states that third parties dealing with a corporation are deemed to have constructive notice of the registered public documents of the corporation), if the corporate authority of a foundation to give monies to charities other than the parallel operating charity has not been effectively communicated to its donors, particularly where the foundation has the same name as the parallel operating charity, and the public fundraising campaign makes reference to the need to support the parallel operating charity, donors who make gifts to the foundation might allege breach of an implied special purpose trust fund under s.6 or

⁶⁵ *Ibid.* at para. 277.

⁶⁶ *Ernest v. Nicholls* (1857), 6 H.L. Cas 41, 10 ER 1351. See also Ontario Law Reform Commission, *supra* note 6 at 469.

s.10 of the *Charities Accounting Act*,⁶⁷ if the monies are disbursed to charities other than the parallel operating charity.

- To overcome potential problems in this regard, it would be advisable for a foundation having objects allowing it to fund a broad spectrum of charities to ensure it has given donors clear written communication of this broad corporate authority – through brochures and annual reports, for example – to refute future allegations that an implied special purpose trust fund had been created by the foundation to benefit only the parallel operating charity.
- Even though the courts in both *Christian Brothers Gen. Div.* and *Christian Brothers Ont. C.A.* held that unrestricted charitable gifts are owned beneficially by a charitable corporation and not held in trust for its charitable purposes, such property may still only be used in accordance with the corporate objects of the charitable corporation in compliance with the doctrine of *ultra vires*; otherwise, the board members of a charity could be found personally liable for losses which arose out of *ultra vires* actions they authorized. As such, there are similarities between an implied special purpose trust fund and an unrestricted gift to a charity. In both situations, there is an implied restriction on what the charity can do with the gift that has been received, with corresponding personal liability consequences to the board members if they fail to comply. With an implied special purpose charitable trust fund, the trust restrictions are gleaned from circumstantial evidence; with an unrestricted charitable gift, the restrictions are found in the charitable objects themselves. In accordance with the doctrine of constructive notice,⁶⁸ a donor is entitled to presume that the charitable objects of a charitable corporation are in fact those that are set out in its letters patent.
- This in turn raises an interesting question. Does a charity have corporate authority to transfer unrestricted charitable property to another charity whose objects are significantly different from, or opposed to, its own objects? For instance, would a charity with objects that are dedicated to helping women facing crisis pregnancies to carry their unborn

⁶⁷ *Supra* note 12.

⁶⁸ *Supra* note 22.

children to term in accordance with a “sanctity of life” philosophy statement be permitted to transfer some or all of its unrestricted funds to a registered charity that operates an abortion clinic? Does it suffice that the recipient charity is a “qualified donee” under the *Income Tax Act*?⁶⁹ Since the definition of a “qualified donee” in the *Income Tax Act* includes non-charities, such as municipalities, a similar question arises in situations where a charity transfers charitable property to a municipality. Simply because a transfer of charitable property complies with the provisions of the *Income Tax Act* does not necessarily mean that such a transfer complies with either corporate law or, when applicable, charitable trust law. In such situations, it may be open to a donor to argue that the charity’s transfer of unrestricted charitable property was outside of its charitable purposes, either as an action *ultra vires* the corporate authority of the charitable corporation, or in breach of an implied or express trust in relation to a charitable purpose trust.

- To avoid such allegations, it is important that a charity include in its constating documents, either in its letters patent or declaration of trust, a provision stating that the charity has the authority to transfer funds to “qualified donees” as defined in the *Income Tax Act* and that such corporate power be communicated to donors either by providing a copy of the objects and power clauses in the annual report for the charity or by referring to such corporate authority in a donor information package.

2. Donor-Advised Funds and Precatory Trusts

a) 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

⁶⁹ *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.). Section 149.1(6) of the *Income Tax Act* allows registered charities to disburse up to 50 per cent of their incomes to “qualified donees”, which according to s.110.1(1)(a) and (b), includes registered charities and other specified non-charities, including municipalities.

obligation upon the charity. This notwithstanding, there is normally considerable moral obligation placed upon a charity receiving such a form of gift.

b) 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, CRA 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 CRA but the further designation that the gift *must* be used to support a particular missionary would not be acceptable to CRA, 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

⁷⁰ *Supra* note 11 at 396.

⁷¹ *Ibid.*

would constitute a designated gift or precatory trust because it would not be binding on the charity.

c) 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*

⁷²Gammon & 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.

Act,⁷³ the option of using donor-advised funds may become more attractive for many charities and foundations, particularly for community foundations.

3. Conditional Gifts

a) 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

⁷³R.S.C. 1998, c. 19, s.22.

⁷⁴Hubert Picarda, *The Law and Practice Relating to Charities*, 2nd ed. (London: Butterworths, 1995) at 202.

⁷⁵Tudor, *supra* note 22 at 146–47.

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

b) 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.

⁷⁶ *Supra* note 6 at 408.

⁷⁷ *Supra* note 8 at 248.

⁷⁸ Waters, *supra* note 22 at 143.

c) 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 CRA that the original gift is being returned to the donor in accordance with the failure of a condition subsequent so that CRA 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

⁷⁹*Supra* note 8 at 231.

⁸⁰*Supra* note 22 at 143.

⁸¹*Ibid.* at 147.

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.

4. 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 CRA 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.

5. 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

⁸²Supra note 74 at 202–03.

⁸³Supra note 22 at 142.

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*.

6. 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 receipted 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.

F. WHAT HAPPENS WHEN THERE IS A FAILURE OF A DONOR RESTRICTION?

1. 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.

2. 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.

3. 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

⁸⁴*Ibid.* at 432.

⁸⁵*Weir v. Crum-Brown*, [1908] A.C. 162 at 167, 77 L.J.P.C. 41 (H.L.) at 127.

⁸⁶*Supra* note 6 at 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.).

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

4. Failure of a Special Purpose Charitable Trust

a) 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

b) 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

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* note 74 at 202.

⁹⁰*Supra* note 22 at 245–46. See also Picarda, *supra* note 11 at 367.

⁹¹George G. Bogert, *The Law of Trust and Trustees*, 2nd ed. (St. Paul: West Publishing, 1964), para. 431 at 490.

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 not with-standing 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.

c) *Cy-près* Scheme-Making Power

i) 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

ii) 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

⁹²*Supra note 5* at para. 399.

⁹³For 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 at 3.

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;

⁹⁴*Supra* note 6 at 403 and 405.

⁹⁵*Supra* note 31.

⁹⁶Tudor, *supra* note 22 at 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* note 8 at 620–21.

- 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.

iii) 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

⁹⁷See *McMichael v. Ontario* (1997), 154 D.L.R. (4 th) 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. (4 th) vii, 227 N.R. 395n.

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

d) 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

⁹⁸*Supra* note 6 at 429.

⁹⁹See *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* note 6 at 431.

¹⁰⁰*Supra* note 6 at 431.

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

G. WHAT ARE THE DUTIES ASSOCIATED WITH DONOR-RESTRICTED CHARITABLE GIFTS?

1. 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.

2. 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

¹⁰¹Chris Abbinanet, "Protecting 'Donor Intent' in Charitable Foundations: Wayward Trusteeship and the Barnes Foundation" (1997), 145 U. Pa. L. Rev. 665 p. 683.

¹⁰²*Supra* note 97.

¹⁰³*McMichael Canadian Art Collection Act 2000*, R.S.O. 1990, c. M. 4.

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 in-tended 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.

¹⁰⁴ *Supra* note 22 at 245; *supra* note 74 at 367.

¹⁰⁵ *Ibid.*, see also *Young Women's Christian Association Extension Campaign Fund (Re)*, *supra* note 31 and *Baker (Re)*, *supra* note 99.

- 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.

3. 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

¹⁰⁶*Trustee Act*, R.S.O. 1990, c. T.23.

¹⁰⁷For 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].

4. 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.

5. 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

6. 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

¹⁰⁸*Supra* note 22 at 254.

¹⁰⁹Enacted by S.O. 1997, c. 23, s.3(4) (Bill 61).

¹¹⁰*Supra* note 22 at 254; *supra* note 74 at 367.

¹¹¹*Supra* note 74 at 374.

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.

H. 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.

1. Consequences Under Common Law

a) 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.

b) 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

¹¹²Section 5.1 amended by 1996, c. 25, s.2(1) (Bill 79).

¹¹³See *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.).

resulting loss by virtue of having directly or indirectly approved an unauthorized activity of the charity outside of its corporate powers.

c) 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

d) 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.

2. Consequences Under Statute Law

a) 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.

¹¹⁴*Anglican Diocese of Algoma v. Algoma University*, supra note 60.

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.

b) *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.

3. 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...”.

¹¹⁵*Public Inquiries Act*, R.S.O. 1990, c. P. 41.

¹¹⁶R.S.C. 1985, c. c-46.

4. 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

¹¹⁷Bill 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.

¹¹⁸For 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).

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.

I. 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.

1. 10-Year Gifts

a) 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.

¹¹⁹Information Circular 80-10R Registered Charities: Operating a Registered Charity, para. 37, Part IV.

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 CRA before adopting this practice.

b) 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 disbursement 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 sub-section 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, former Director of Policy and Communications for the Charities’ Directorate of CRA, 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 therefore, 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

¹²⁰Letter of Carl Juneau, Director of Policy and Communications Division Charities’ Directorate, Canada Customs and Revenue Agency to Terrance Carter (21 September, 2000).

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*.

c) 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 therefore*” 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 CRA 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 CRA.

d) 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.

e) 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.

f) Managing 10-Year Gifts

Although many charities customarily commingle 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 CRA takes the position that any capital gains accruing on the original gift or “*property substituted there-for*” 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.

2. 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 CRA 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.

CRA 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 CRA 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, CRA 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 CRA before the charity issues a tax receipt to the donor involving any type of gift involving a condition subsequent.

3. 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 CRA, 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

¹²¹ *Supra* note 8 at 136.

¹²² *Ibid.* at 153.

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 CRA 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 CRA 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;

¹²³Short, TCM 1997-255; *Hope*, 68 AFTR (2d) 91-5396 (Cls. Ct., 1991); *Goldstein*, 89 T.C. 535 (1987).

¹²⁴For 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 at 155.

- 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

¹²⁶*Ibid.* at 115.

¹²⁷*Ibid.* at 116.

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 CRA if necessary.

As the issue of excessive donor control will probably become a matter of greater regulation by CRA, 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 CRA, 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 there from in furtherance of the charitable purposes of the charity.
- In circumstances where the extent of donor control might be questioned by CRA 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 CRA on the issue of whether the donation was a gift at law for which a charitable receipt could be issued.

4. 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

¹²⁸*Black’s Law Dictionary, supra note 4, s.v. “gift.”*

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.

¹²⁹See 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.

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

J. WHO CAN ENFORCE DONOR RESTRICTIONS?

1. 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.

2. 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.

¹³⁰For 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).

¹³¹Waters, *supra* note 8 at 128; Ontario Law Reform Commission, *supra* note 6 at 390–91.

3. 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

¹³²*Supra* note 101.

¹³³Carl J. Herzog Foundation v. University of Bridgeport (Conn. Sup. Ct.1997). See *supra* note 72 at 1.

¹³⁴*Supra* note 97.

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

¹³⁵See 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* note 103.

¹³⁷Sarah 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.

¹³⁸For a more complete discussion of the effect of s.6 of the *Charities Accounting Act* and the applicable case law under it, see *supra* note 3 at 272–74.

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.

K. EXIGIBILITY OF SPECIAL PURPOSE CHARITABLE TRUSTS

1. Importance of the Issue

The decision of Feldman J.A. in *Christian Brothers Ont. C.A.* concerning the eligibility 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 eligibility 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 eligible 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 eligible 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 eligibility 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 eligibility. 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.

2. 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 eligible 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 eligible 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

¹³⁹For 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* note 6.

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.

3. 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

¹⁴²For 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.

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.

4. 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 eligible 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

L. 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

¹⁴³Although 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.

¹⁴⁴See Carter, *supra* note 130, available at www.charitylaw.ca.

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:

1. 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.

2. 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.

3. 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 under-write 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 commingled 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 commingling of restricted funds by a charity; however, it is likely that such regulations will impose some restrictions on the ability to commingle.
- 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

¹⁴⁵ *Ibid.* at 186. 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.).

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.

M. 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 refer 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.

N. 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.

O. 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 practice 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.

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.).