

CONSIDERATIONS WHEN DRAFTING RESTRICTED CHARITABLE PURPOSE TRUSTS[†]

*Terrance S. Carter**

TABLE OF CONTENTS

A.	Introduction	362
B.	What are the Different Types of Restricted Charitable Gifts?	365
	(1) Special Purpose Charitable Purpose Trusts	366
	(a) Long-Term Gifts, Including Endowments	368
	(b) Restricted-Use Gifts	371
	(c) Restricted Charitable Trust Property	374
	(d) Implied Special Purpose Charitable Trust Funds	375
	(2) Precatory Trusts and Donor-Advised Funds	378
	(3) Conditional Gifts	380
	(4) Determinable Gifts	382
C.	What Provisions Should Be Considered When Drafting Restricted Charitable Purpose Trusts?	383
	(1) Initial Considerations Involving Endowment Funds	383
	(2) Thresholds in Establishing a Restricted Charitable Purpose Trust	384
	(3) Description of Restricted Purpose	385
	(4) Assets Forming the Trust	385
	(5) Naming Rights	386
	(6) Disbursing Trust Funds	387
	(7) Donor-Advised Provision	387
	(8) Administration Fee	388
	(9) Investing Trust Moneys	388
	(10) Variation of the Trust	389
	(11) Transfer of Trust Property	389
	(12) Return of the Gift	390
	(13) Anti-Terrorism Considerations	391
	(14) Independent Professional Advice	391
	(15) Considerations When Drafting Board-Created Restricted Charitable Purpose Trusts	391
D.	Conclusion	392

[†] This is an edited version of a paper presented at the ONTARIO BAR ASSOCIATION programme entitled TRUSTS, TRUSTEES, TRUSTEESHIPS in Toronto, Ontario on October 1, 2010 and is based in part on Terrance S. Carter, “Donor-Restricted Charitable Gifts: A Practical Overview Revisited II” (presented for the Canadian Association of Gift Planners at the *2006 Annual National Conference*, 2006), online: <<http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>>.

* Terrance S. Carter, Carters Professional Corporation, <<http://www.charitylaw.ca>>.

A. Introduction

This article will highlight some of the more common issues that lawyers should be aware of when drafting the provisions of a testamentary or *inter vivos* restricted charitable purpose trust. As always, lawyers must take the time to tailor the restricted charitable purpose trust to fit the factual context and needs of the particular donor or charitable client as the case may be.

The key element of both testamentary and *inter vivos* restricted charitable purpose trusts is the establishment of the restriction, whether the restriction is with regards to the use or with regards to the time during which the charitable gift is to be applied. If a charity accepts a gift subject to a restricted charitable purpose trust, the charity is legally bound by those restrictions. This form of gift, whether the charity understands it or not, establishes a special purpose charitable trust within the charity itself and the charity, as trustee, is subject to the legal regime governing such trusts. Common types of restricted charitable purpose trusts include endowments, long term funds, scholarship funds, building funds, as well as donor advised funds that are often placed with community foundations, to name a few examples.

As donors become more sophisticated with their giving and demand greater accountability from charities, the use of restricted charitable purpose trusts is becoming a more frequent fundraising vehicle, particularly for donors making large gifts to charities. Many charities in Canada, though, do not fully appreciate the legal implications of accepting restricted charitable purpose trusts. Failing to honour the restrictions imposed by such trusts could expose the charity, and its directors or trustees, to liability for breach of trust. As well, failure to comply with the restrictions has the potential to erode donor confidence and undermine the credibility of the recipient charity as well as the charitable sector in general.

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

- A charitable purpose trust is an exception to the rule that purpose trusts are void.
- A charitable purpose trust is exempt from the requirement that there be a beneficiary of the trust. In Ontario, this means that there is no one to enforce the trust other than the Public Guardian and Trustee, under the authority of the Attorney General, in accordance with that office's traditional *parens*

patriae role in overseeing charitable purposes.

- A charitable purpose will not fail for uncertainty of objects, even though there are no identifiable beneficiaries, provided that the purpose is exclusively charitable. Trustees for charitable trusts may be given discretion to make a determination about whether or not an individual is one of the intended beneficiaries.¹
- The court is prepared to write or rewrite a charitable purpose trust in certain limited circumstances 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.²
- The prohibition against remoteness of vesting, otherwise known as the “modern” rule against perpetuities, does not apply to charitable purpose trusts.
- 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 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.³
- The rules of law and statutory enactments relating to accumulations do not apply to charities.⁴
- Perhaps the best-known advantages accorded to charities are those that derive from taxing statutes. The *Income Tax Act* (“*ITA*”), for example, exempts the income of registered charities

1. Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, 3rd ed. (Markham: LexisNexis Canada, 2002), at p. 39.
2. Donovan W.M. Waters, Mark R. Gillen, and Lionel D. Smith, eds., *Waters’ Law of Trusts in Canada*, 3rd ed. (Toronto: Thomson Canada, 2005), at p. 642.
3. For a discussion of the rule against perpetuities, see Adam Parachin, “Charities and the Rule Against Perpetuities” (2008), Vol. 21, No. 3, *The Philanthropist*, at p. 256. This paper was also presented at the 2007 National Charity Law Symposium on May 10, 2007.
4. *Accumulations Act*, R.S.O. 1990, c. A.5, s. 4. For more information on the changes caused by the *Good Government Act, 2009*, see Terrance S. Carter, “Bill 212 Brings Significant Reform to the Regulation of Charities in Ontario” in *Charity Law Bulletin*, No. 181 (November 26, 2009), online: <<http://www.carters.ca/pub/bulletin/charity/2009/chylb181.htm>>. See also Terrance S. Carter, “Good News — Bill 212 Receives Royal Assent” in *Charity Law Update* (December 2009), online: <<http://www.carters.ca/pub/update/charity/09/dec09.pdf>>, and Terrance S. Carter, “Breaches of the *Charitable Gifts Act* ‘Cured’ by Bill 212” in *Charity Law Update* (January 2010), online: <<http://www.carters.ca/pub/update/charity/10/jan10.pdf>>.

from tax and allows registered charities to issue receipts for donations, thus enabling the tax payer to claim a tax credit for the money given if the tax payer is an individual and a tax deduction if it is a corporation.⁵

However, there are also some restrictions on the use of charitable purpose trusts. For example, a charitable purpose trust must be devoted exclusively to charitable purposes. If not, the trustee would have the discretion to use the funds for either charitable or non-charitable (*i.e.*, invalid) purposes, and therefore the trust would be void. Many cases that address whether a trust is devoted exclusively to charitable purposes focus on the wording of the trust, because the courts have interpreted terms such as “objects of liberality”,⁶ “benevolent objects”,⁷ and “philanthropic purposes”⁸ as not referring exclusively to charitable purposes. In every case, a court will search for the expressed intention of the creator of the trust. In this regard, drafters of charitable purpose trusts have a responsibility to ensure that the wording of the trust is sufficient to uphold the finding of a charitable purpose trust.⁹

Furthermore, trusts for political purposes (even if otherwise for charitable purposes) are invalid. “Political purposes” does not mean only direct political party activity; it also includes the promotion of political ideas and any attempts to influence the legislative or executive process. Although some commentators have been critical of the political purposes doctrine, it remains alive and well in Canada.¹⁰

A restricted charitable gift generally means a gift at law to a charitable purpose that is subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors.¹¹ These limitations are imposed by the donor and serve to constrain or limit a charity concerning how the gift can be used.

While unrestricted charitable gifts are beneficially owned by a

5. R.S.C. 1985, c. 1 (5th Supp.), ss. 118.1 and 110.1, as amended, establishes the tax credit and the deductibility of donations by individuals and corporations to “registered charities”, which are defined in subsec. 248(1).

6. *Morice v. Bishop of Durham*, (1804), 32 E.R. 656, at p. 658.

7. *Chichester Diocesan Fund and Board of Finance (Inc.) v. Simpson*, [1944] A.C. 341 (H.L.).

8. *Brewer v. McCauley*, [1955] 1 D.L.R. 415, [1954] S.C.R. 645.

9. Mark R. Gillen and Faye Woodman et al., *The Law of Trusts: A Contextual Approach*, 2nd ed. (Toronto: Emond Montgomery, 2008), at pp. 271-276 for a more detailed discussion of the requirement of exclusive purposes.

10. See, for example, *Human Life International in Canada Inc. v. M.N.R.*, [1998] 3 F.C. 202, [1998] 3 C.T.C. 126, 98 D.T.C. 6196 (F.C.A.), leave to appeal to S.C.C. refused [1998] S.C.C.A. No. 246.

11. See also *Black's Law Dictionary*, 8th ed. (St. Paul, Minn.: Thomson/West,

charity for its general charitable purposes, restricted charitable gifts, when structured as a restricted charitable purpose trust as opposed to other forms discussed below, are held by the charity in trust for the purposes specified by the donor and are not actually owned beneficially by the charity. In that situation the charity is, in fact, holding the gifted property subject to a specific charitable purpose trust within the confines of its own general charitable purpose (in essence a charity within a charity). Although for trust law purposes each restricted charitable purpose trust is a separate trust, as long as the trustee is already a registered charity, a charitable purpose trust is not required to be registered by Canada Revenue Agency (“CRA”) as a separate registered charity.¹²

The board of a charity that receives a 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. Sometimes lawyers advising charitable clients may not identify or adequately understand the nature of the donor restriction that has been imposed. This, in turn, can expose charities and their boards of directors to unnecessary and potentially serious liability.

B. What are the Different Types of Restricted Charitable Gifts?

Before drafting a testamentary or *inter vivos* restricted charitable purpose trust, it is important to understand the different types of restrictions that can be imposed. In this regard, it is also important to understand that not all restrictions associated with charitable gifts necessarily involve a restricted charitable purpose trust. For instance, a gift subject to a condition subsequent (*i.e.*, “I give \$100,000 to Hospital A on the condition that Hospital A commences construction of a cancer wing prior to January 1, 2011”) will involve the imposition of a restricted gift by the donor but the

2004), *s.v.* “restrict” and “restriction”, which is defined as “To restrain within bounds; to limit; to confine”.

12. Canada Revenue Agency, “Summary Policy CSP-R22: Restricted Fund” (September 3, 2003; revised November 23, 2005), online at: <<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/csp/csp-r22-eng.html>>. For an explanation regarding how this applies to restricted charitable purpose trusts, see Terrance S. Carter, “Donor-Restricted Charitable Gifts: A Practical Overview Revisited II” (presented for the Canadian Association of Gift Planners at the 2006 Annual National Conference, 2006) online: <<http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>>, at p. 12.

restriction in the form of a condition precedent will not constitute a restricted charitable purpose trust. As such, it is necessary to understand the differences between a restricted charitable purpose trust in its various forms as compared to other types of restricted charitable gifts in order to better understand what can be imposed as restrictions on a restricted charitable purpose trust and what cannot be. In this regard, this section of the article will discuss the restrictions that apply to restricted charitable purpose trusts by utilizing the term “special purpose charitable trusts”, which is the specific terminology that the courts normally use when referring to a restricted charitable purpose trust. In the next section of the article, an explanation is provided concerning other types of restricted charitable gifts for comparison purposes, including donor-advised funds, precatory trusts, conditional gifts, determinable gifts, and gifts subject to direction under the *Charities Accounting Act*.¹³

(1) Special Purpose Charitable Purpose Trusts

In general terms, when the courts refer to a special purpose charitable trust, they are meaning 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 of a charitable corporation would be acting outside of its authority (whether it be *ultra vires* where the doctrine still applies or simply a breach of fiduciary duties where it does not apply) if it were to authorize the corporation to hold property as a special purpose charitable trust where such purpose was outside the scope of the charity’s corporate objects.

To the extent that a gift constitutes a special 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 Supreme Court of Canada has confirmed this common law principle:¹⁴

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.

Special purpose charitable trusts are also commonly referred to as “donor-restricted trust funds”, “charitable trust property”,

13. R.S.O. 1990, c. C.10.

14. *Towle Estate v. Canada (Minister of National Revenue - M.N.R.)*, [1966] S.C.J. No. 66, 60 D.L.R. (2d) 481, [1967] S.C.R. 133, *sub nom. Guaranty Trust Co. of Canada v. M.N.R.*

“charitable purpose trusts”, “restricted charitable purpose trusts”, “restricted funds”, “special purpose funds”, and sometimes as “endowment funds”. As indicated above, the general terminology that will be used in this section of the article is “special purpose charitable trusts”. 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, such as when money has been raised for an endowment program or through a public fundraising appeal for a specific project. However, there are conflicting approaches concerning what type of evidence will be required to establish that the donor had the necessary intent to in fact create a special purpose charitable trust. In *Christian Brothers of Ireland in Canada (Re)*¹⁵ Blair J. held that there is a higher, more formal standard that is required, whereas in *Rowland v. Vancouver College Ltd.*,¹⁶ Levine J. determined that the applicable requirements are less formal and can involve consideration of all relevant circumstances involved in making the gift.

Blair J. stated that before there can be a “true” special purpose charitable trust, the trust must first be established with the general formal requirements of trust law: certainty of intention, certainty of subject matter, and certainty of objects. In addition to requiring all 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, unless there is evidence that gives rise to the creation of a special purpose charitable trust (meaning where it was created in accordance with the above-noted formalities). Blair J. describes gifts where donors have not formally expressed an intention sufficient to create a special purpose charitable trust to be “precatory trusts”.

However, the approach taken by Levine J. 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. 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”, but rather requires that the court look at all of the relevant circumstances to determine the real intention of the

15. (1998), 37 O.R. (3d) 367, 21 E.T.R. (2d) 93, 38 B.L.R. (2d) 286 (Gen. Div.) (“*Christian Brothers* (Gen. Div.)”), revd in part 184 D.L.R. (4th) 445, 47 O.R. (3d) 674, 33 E.T.R. (2d) 32 (C.A.) (“*Christian Brothers* (C.A.)”).

16. (2000), 34 E.T.R. (2d) 60, [2000] 8 W.W.R. 85, 2000 BCSC 1221, affd 205 D.L.R. (4th) 193, 41 E.T.R. (2d) 77, 2001 BCCA 527 (“*Christian Brothers* (B.C.S.C.)”).

donor. Levine cites *Waters' Law of Trusts in Canada* with approval, which states that "there is no need for any technical words or expressions for the creation of a trust".¹⁷

The dichotomy between the approaches of Blair J. and Levine J. remains unresolved. Until further judicial guidance is available on this matter, it would be prudent for legal counsel to be careful in ensuring that the formalities required for the creation of a special purpose charitable trust are carefully articulated in the document creating a restricted gift, whether it be through an *inter vivos* gift 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 a restricted gift might become the basis of criticism or even a claim in negligence for not ensuring that the intent of the donor had been adequately expressed to create a binding special purpose charitable trust capable of effectively restricting the charity in the future.

What now follows is a description of different types of special purpose charitable trusts.

(a) Long-Term Gifts, Including Endowments

One type of restriction applicable to a special purpose charitable trust is a restriction involving the length of time that a gift is held, generally in the context of creating some type of long-term gift. In this regard, a long-term gift to a charity is a gift where the capital is held in trust, in whole or in part for a period of time, where the income and eventually the capital is used either for a specific application, like a scholarship, or for the general charitable purposes of the charity. Some long-term gifts are directed to be held in perpetuity as endowments, while others are to be held for a fixed number of years. Long-term gifts can be subject to a possible right of encroachment by the charity on the capital during the hold period if the donor has built that right within the wording of the gift agreement. Once the hold period has expired (except where the donor directs that the gift be held in perpetuity with no right of encroachment), the entire gift can be disbursed by the charity.¹⁸

17. Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *op. cit.*, footnote 2, at p. 132.

18. Robert Hayhoe, "A Sketch of the Income Tax Treatment of Endowments," (2010), Vol. 23, No. 1, *The Philanthropist*, online: <<http://www.millerthom->

An endowment is the extreme form of a long-term gift. It 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 or perpetual 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 non-profit organization under subsec. 149.1(1) of the *ITA*, since a non-profit organization does not constitute a charitable purpose trust at law.

The capital of a long-term gift, including an endowment fund, is normally invested in accordance with either the investment terms contained in the document creating the gift or in accordance with the investment powers of the charity as set out in its constating documents or in an investment policy that has been adopted by the charity. 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 gift agreement or the investment policy established by the board of the charity in accordance with its corporate investment powers. Unless the terms of the long-term gift 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 long-term fund, particularly with an endowment, will at least keep up with inflation and will preferably increase on a net basis over the years.

How the income earned on a long-term gift is applied depends upon whether the donor has expressed a specific direction concerning disbursement of income in the gift agreement or, alternatively, whether the board has established terms of reference concerning how income from a long-term gift 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 long-term 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.

There are three ways in which long-term funds, including endowments, can be created: by the board, by the donor, or by a combination of the two. These three methods also apply to other types of special purpose charitable trusts described later in this section of the article. When the long-term fund is initiated by the donor, it will normally involve the donor leaving money through a

son.ca/assets/files/article_attachments/A_Sketch_of_the_Income_Tax_Treatment_of_Endowments.pdf> .

testamentary gift or, alternatively, creating a long-term fund by means of an *inter vivos* gift agreement. If a long-term gift agreement is utilized, 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 long-term fund, the name of the long-term fund, as well as disbursement of the income from the long-term fund will normally be addressed. These issues are discussed in more detail later in Section C of this article.

Alternatively, when the board of a charity takes steps to create a long-term fund itself, it usually advises potential donors that a long-term fund, including an endowment fund, has been established by the charity and invites donors to contribute to it. Another example of a board-created long-term fund is where the board sets aside unrestricted funds and directs that they be applied to a specific purpose. The board will establish the terms of reference for the long-term fund, including how the income will be disbursed and how the fund will be invested. It will also normally have a descriptive name associated with such fund, such as "The Scholarship Fund", or "Research Fund", so that prospective donors can identify it when making a contribution.

In the third type of long-term fund, the board invites donors to establish individual long-term funds with the charity. This allows the donor (within the parameters of the charitable purposes of the charity and subject to the approval of the charity) to structure the long-term fund, including a perpetual fund, on a more customized basis. This type of long-term gift is often encountered with community foundations and may involve the donor being able to name the long-term 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 a long-term fund of its own creation and reserves the right to redesignate these funds to a different application at a later time, such a contribution would constitute a commingling of restricted trust funds and unrestricted funds and would be prohibited at common law. In a similar vein, any moneys that are contributed by donors to either a board-initiated long-term fund or a fund that is initiated by the donor in accordance with the formal requirements of a special purpose charitable trust cannot be applied to a different purpose at the direction of either the board or the donor without court approval unless the terms of the gift agreement or the terms of the board-initiated fund provide the charity with the ability to vary the terms of the long-term gift.

When considering drafting a long-term gift, it is important to be

aware that until recently in Ontario, the income of a gift was subject to the ordinary rules that precluded accumulations for longer than 21 years.¹⁹ The rule against accumulations provides that no disposition of property may direct the accumulation of income deriving from that property for any period of time longer than the permissible accumulations period. The *Accumulations Act* provides for six possible accumulation periods,²⁰ and if the terms of the trust provided for the accumulation of income beyond one of those six periods, the charity was forced to distribute the income in a prescribed manner.²¹ This was a concern for charities holding property in trust on a long-term basis on terms that allowed for the capitalization of income to be derived from property.

However, the recent passage of the *Good Government Act, 2009*,²² has amended Ontario's *Accumulations Act* so that "[t]he rules of law and statutory enactments relating to accumulations do not apply and shall be deemed never to have applied to trusts created for a charitable purpose, as defined in section 7 of the *Charities Accounting Act*".²³ This is a welcome relief for charities operating in Ontario, as they no longer have to be concerned with drafting restricted charitable purpose trusts in a way that avoids the application of the *Accumulations Act*.²⁴

(b) Restricted-Use Gifts

Unlike long-term funds, restricted-use funds do not require that the capital of a gift be held in trust for a specific period of time, although a time restriction can apply as well. Instead, the capital, as well as income, will be applied in accordance with applicable charitable purpose restrictions, and the capital and income will be applied either immediately or over a relatively short period of time (such as with a building fund), so that the restrictions will eventually be fulfilled, thereby bringing the special purpose charitable trust fund to an end.

Common use restrictions imposed by donors in this regard include restrictions concerning how a gift will be applied to further a particular capital use, such as a building program, or an operational use, such as a relief effort in a foreign country. In either situation, it is

19. See the *Accumulations Act*, *supra*, footnote 4.

20. *Ibid.*, at s. 1(1).

21. *Ibid.*, at s. 1(6).

22. S.O. 2009, c. 33.

23. *Ibid.*

24. For more information on the changes wrought by the *Good Government Act, 2009*, see Terrance S. Carter, *op. cit.*, footnote 4.

essential that the use 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 be in breach of trust and will be liable for having authorized an *ultra vires* activity outside of the corporate authority of the charity if it is a charitable corporation and the doctrine of *ultra vires* still applies. A use restriction can be combined with a time restriction, such as a long-term gift as described above (including an endowment). An example of a combination would be a scholarship fund for music students to be held for at least 20 years.

Donors may also establish use 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. The general law is that any restrictions that are discriminatory will be void unless they discriminate in favour of historically disadvantaged groups (*e.g.*, women, people of colour).²⁵ The courts, however, have found that certain types of restrictions that prefer one class of persons are not void. For example, one case addressed gifted property that was to be used to provide bursaries to Catholic students. The court held that the discriminatory language was "relatively innocuous" and was not offensive to the degree necessary to warrant undermining the testator's right to testamentary freedom.²⁶

As with long-term funds, restricted-use funds can be established at the initiation of the donor, either through an *inter vivos* or testamentary gift that includes a time or a use restriction, or both. 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 restricted fund meets the formal requirements of a trust, the moneys received will generally constitute a restricted charitable purpose trust to be used in furthering a designated charitable purpose, such as a building program for a new church or a new wing for a hospital.

25. See, for example, *Levy Estate (Re)* (1989), 58 D.L.R. (4th) 375, 68 O.R. (2d) 385, 33 E.T.R. 1 (C.A.), and *Canada Trust Co. v. Ontario (Human Rights Commission)* (1990), 69 D.L.R. (4th) 321, 74 O.R. (2d) 481, 38 E.T.R. 1 (C.A.).

26. *University of Victoria v. British Columbia (Attorney General)* (2000), 185 D.L.R. (4th) 182, 32 E.T.R. (2d) 298, 73 B.C.L.R. (3d) 375 (S.C.).

For the charity, restrictions on how gifted property can be used raise a number of issues that should be carefully considered before the charity accepts the gift. One issue is whether the restricted gift is exclusively charitable. If the restriction requires that the gifted property can be used in a manner that is not exclusively charitable, then the trust is invalid and the gift fails. Determining whether or not particular restrictions on the use of gifted property are exclusively charitable is not always easy, as there is no precise legal definition of what is charitable. Instead, the gifted property must be able to be used in a manner that falls within one of the four general heads of charity.²⁷

In addition to falling within one of the four heads of charity, the particular use of gifted property must be for the public benefit, meaning that it must benefit the public at large or a significantly large section of the public.²⁸ Over the years, there have been many cases which have considered whether a particular restricted purpose falls within one of the four heads of charity and whether it is for the public benefit.²⁹ The results of those cases often turn on subtle distinctions in the wording of the restriction. One example that illustrates the significance of subtle distinctions in wording is the *Diplock* case³⁰ in which the court determined that while a trust for “charitable and benevolent” purposes is charitable, a trust for “charitable *or* benevolent” purposes is not. Accordingly, if the charity does not have an opportunity to provide input into the drafting of the restriction, it should ask legal counsel to confirm that the gift is exclusively charitable prior to accepting the gift.

Even if the gift is exclusively charitable at law, the charity must not accept a restriction on the use of the gifted property that is not within the objects of the charity. If the charity accepts a restricted gift that requires the charity to use the gifted property in a manner that is not contemplated by the charity’s objects, the directors or trustees of the

27. There are four general heads of charity recognized by the courts: the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community. For a more detailed discussion, see *Income Tax Special Purposes Commissioners v. Pemsel*, [1891] A.C. 531, [1891-94] All E.R. Rep. 28, 3 T.C. 53 (H.L.) and *Vancouver Society of Immigrant and Visible Minority Women v. Canada (Minister of National Revenue)*, [1996] 169 D.L.R. (4th) 34, [1999] 1 S.C.R. 10, 59 C.R.R. (2d) 1.

28. For information on meeting the “public benefit” test, see Canada Revenue Agency, “Policy Statement CPS-024: Guidelines for Registering a Charity: Meeting the Public Benefit Test” (March 10, 2006), online: <<http://www.cra-arc.gc.ca/tx/chrts-gvng/chrts/plcy/cps/cps-024-eng.html>>.

29. See, for example, *Vancouver Regional FreeNet Assn. v. M.N.R.* (1996), 137 D.L.R. (4th) 206, [1996] 3 F.C. 880 (F.C.A.).

30. *Ministry of Health v. Simpson*, [1951] A.C. 251 (H.L.), affirming *Re Diplock*, [1948] Ch. 465 (C.A.).

charity can be personally liable for the actions of the charity in doing so.

Even if there are no legal impediments to accepting a restricted use gift, there may be practical reasons why the charity may want to decline the gift. A charity may not have the capacity to comply with restrictions that are incompatible with its mission. Alternatively, the administrative requirements of a restricted gift may consume an inordinate amount of the charity's resources. In such circumstances, the charity would best serve its charitable objects by declining the gift. In this regard, it would be prudent for charities to adopt a policy that all restricted gifts need to be approved by the directors or trustees of the charity or by senior management where the board has delegated that authority. Charities should also avoid simplistic targets or quotas that encourage development staff to accept restricted gifts that are not in the best interests of the recipient charities.

(c) Restricted Charitable Trust Property

Restricted charitable trust property is a term used to describe real estate that is gifted subject to certain terms of trust, usually contained in the deed to the property. Religious charities often receive or acquire property through deeds that set out specific terms of trust which may 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, particularly a religious charity, determine whether or not any of its real property, either now or in the past, is subject to restricted charitable purpose trusts and, if so, to ensure that the property either was, or is, currently being used in accordance with the applicable restrictions.

Generally, restrictions normally found in deeds containing restricted charitable purpose 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" (where the sacrament of

communion can only be received by baptized members of a particular denomination).

What is often not 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 generally 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.

Restricted charitable trust properties are almost invariably created by the inclusion of a specific trust clause in a deed or transfer of land. This can occur when a donor gifts property to a charity and intends the property to be used only for a particular purpose. In such a scenario, the donor may include a reversionary clause in the deed stipulating that the property is to revert back to the donor 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 as is discussed below.

In the other usual 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. The self-imposed terms of trust, though, 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.³¹

(d) 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 restricted charitable purpose 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. On the other hand, even if there is not express language, if the

31. For further discussion regarding how restricted charitable trust properties are created and a discussion of the applicable case law see Terrance S. Carter, *op. cit.*, footnote 12.

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 special purpose charitable trust by implied intent.

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.),³² instances where an implied special purpose charitable trust might be found would include the following:

- A public fundraising campaign initiated by the charity for a specific purpose, whether it be a capital endowment fund or a building project.³³
- 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, such as funding 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. However, some foundations have charitable objects that permit the board of the foundation to use the moneys received by the foundation for purposes other than benefitting the parallel operating charity. Notwithstanding the doctrine of constructive notice,³⁴ (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 moneys 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 could very well allege breach of an implied special purpose trust fund under s. 6 or s. 10 of the

32. See general discussion on special purpose charitable trusts, *ibid.*, at p. 5.

33. *Christian Brothers* (B.C.S.C.), *supra*, footnote 16, at para. 277.

34. *Ernest v. Nicholls* (1857), 6 H.L. Cas. 401. See also Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ministry of the Attorney General, 1996), at p. 469.

*Charities Accounting Act*³⁵ if the moneys 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 both the Ontario Court of Justice and the Ontario Court of Appeal in *Christian Brothers of Ireland in Canada (Re)*³⁶ held that unrestricted charitable gifts are owned beneficially by a charitable corporation and are 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* (pending its removal under the *Canada Not-for-Profit Corporations Act*³⁷ or the *Ontario Not-for-Profit Corporations Act, 2010*)³⁸ or in accordance with the general fiduciary obligation to apply charitable property to its corporate objects;³⁹ 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 of the charity itself. In accordance with the doctrine of constructive notice, 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.

35. *Supra*, footnote 13.

36. *Christian Brothers (C.A.)*, *supra*, footnote 15.

37. S.C. 2009, c. 23.

38. S.O. 2010, c. 15.

39. *Ontario (Public Guardian and Trustee) v. AIDS Society for Children (Ontario)*, [2001] O.J. No. 2170, 39 E.T.R. (2d) 96, 105 A.C.W.S. (3d) 1044 *sub nom. Public Guardian and Trustee v. Aids Society for Children (Ontario)* (S.C.J.).

(2) Precatory Trusts and Donor-Advised Funds

The basic characteristic of donor-advised funds and precatory trusts, in contrast to other forms of restricted charitable gifts, such as special purpose charitable trusts or conditional gifts, is that they do not have any legally 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” rather than a legal obligation upon the charity. This notwithstanding, there are considerable practical consequences, and also significant moral obligations, placed upon a charity receiving such form of gift.

A precatory trust is actually not a trust at all, but only a non-binding request of the donor.⁴⁰ 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 non-binding designation. For ease of reference, such gifts may be referred to simply as “designated gifts”.⁴¹ 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-110R3,⁴² 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 non-binding designation accompanying the gift that, where possible, the donation be used to support a particular missionary. Such a form of designation would constitute a designated gift or precatory trust because it would not be binding on the charity.

Distinguishing precatory wishes from binding trust obligations can be difficult. Clearly the use of phrases such as “in trust”, “on condition that”, or other mandatory language suggest the creation of a legally binding restriction. On the other hand, words such as “wish” or “desire” suggest that the donor did not intend to create a legal

40. *Christian Brothers (C.A.)*, *supra*, footnote 15.

41. This is not to be confused with the term of “designated gifts” referred to in the 2010 federal Budget.

42. Canada Revenue Agency, “IT-110R3: Gifts and Official Donation Receipts” (June 20, 1997), online: <http://www.cra-arc.gc.ca/E/pub/tp/it110r3/it110r3-e.html#P113_3712>.

obligation. The difficulty arises when donors use less than clear or contradictory terminology. In such circumstances, a charity would be prudent to obtain a legal opinion in order to determine whether a trust has been created or not.

A donor-advised fund is a form of designated giving whereby the donor makes a gift to a charity and then periodically makes non-binding recommendations concerning the distribution of assets from the fund to other charities or for certain charitable activities. A donor-advised fund may allow the donor to make recommendations in one or two fashions. One possibility is that the charity may invite the donor to make recommendations on how the annual disbursements to be made by the charity are to be met. As well, some donor-advised funds may also invite donors to recommend how their original donation is to be invested by the charity.⁴³

Donor-advised funds are widely used in the United States where they are frequently 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. 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. In a sense, donor-advised funds create more challenges for the charity than gifts subject to an initial precatory wish, because the charity has a moral obligation (though not a legal duty) to respond to the wishes of the donor on an on-going basis.⁴⁴

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 therefore be receipted under the *ITA*. 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. All rights of ownership must be transferred by the donor to the registered charity, and the recipient charity must retain control over all its decisions, including investing and grant-making. 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 its distribution or application.

The advantage of donor-advised funds is that such funds allow the

43. Susan Manwaring, “Donor Advised Funds: A Growing Option for Canadian Philanthropy” in *Charitable Thoughts*, Vol. 9, No. 2 (October 2005).

44. Terrance S. Carter, *op. cit.*, footnote 12, at pp. 35-37.

donor to receive an immediate tax receipt 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 ability to provide proper administration and guidance from the charity's board of directors.

(3) Conditional Gifts

The distinction between a conditional gift and a restricted charitable purpose trust is not an easy one to make, particularly since a conditional gift can also involve a charitable purpose 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 charitable purpose 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 restricted charitable purpose trust if the gift involves both a condition precedent and a donor requirement that the gift be used for a particular purpose. For example, the donor might say, "I give \$1,000,000.00 as a perpetual endowment for cancer research, on the condition that the charity opens a cancer research facility in Calgary by the year 2012".

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.⁴⁵

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.⁴⁶

The general rule that a charitable purpose is exempt from the rule

45. Hubert Picarda, *The Law and Practice Relating to Charities*, 3rd ed. (London: Butterworths, 1999), at p. 212.

46. Jean Warburton and Debra Morris, eds., *Tudor on Charities*, 8th ed. (London: Sweet & Maxwell, 1995), at p. 191.

against remoteness of vesting, *i.e.*, the “modern rule against perpetuity”, does not apply to a conditional gift. The Ontario Law Reform Commission, *Report on the Law of Charities*⁴⁷ stated that:

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.

Conditional gifts are either subject to a condition precedent or a condition subsequent. A condition precedent occurs when the condition must be fulfilled *before* the gift takes effect (for example, a gift of \$100,000 provided that the registered charity is able to raise an equal amount of money within a stated period of time). 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 remains with the donor. A gift subject to a condition precedent is not a gift at law until after the condition is fulfilled. Accordingly, it is improper for a charity to issue a receipt for tax purposes before the condition precedent is fulfilled.

By contrast, a condition subsequent is a condition which operates to defeat a gift which has already been made (for example, a gift made to a charity on the condition that the funds be used to operate a particular named shelter for the homeless). If the condition subsequent fails and there is a right of reversion in the gift back to the donor, the reversion to the donor will only be operative 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. If there is neither a reversionary right in favour of the donor nor 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. Although a charity may issue a tax receipt for a gift subject to a condition subsequent, if the condition fails and the gift reverts back to the donor, the donor will receive a double benefit. In this regard, CRA advises that the charity returning the gift should inform CRA that the original gift is being returned to the donor so that CRA can ensure the returned gift is reported as taxable income by the donor.⁴⁸

47. *Op. cit.*, footnote 34, at p. 408.

48. Canada Revenue Agency, “Summary Policy CSP-G04: Gift (Conditional)” (September 3, 2003; revised November 23, 2005), online at: <<http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/csp/csp-g04-eng.html>>. For more information on conditions precedent and subsequent, see Jean Warburton and Debra Morris, *op. cit.*, footnote 46, at pp. 143-150.

Often, conditional gifts will be given subject to a “gift over” that will address the situation where the condition has not been met. This means that if the charity fails to comply with the condition, the gift will then transfer to another charity. If a gift over is valid, and the circumstances upon which it was to arise are shown to have happened, the property passes and cannot be recalled. It makes no difference that the gift over is for the benefit of another, different charity. However, lawyers who are instructed to provide for a gift over as part of a restricted charitable purpose trust should ensure that the gift over is to a charity with similar charitable purposes, since a gift over from a charity to a non-charitable purpose is void.⁴⁹

(4) Determinable Gifts

A determinable gift is a technical variation on a gift that is subject to a condition subsequent. 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, such as “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”. It may be limited to endure only during the continuance of a particular state of circumstances, or until the happening of an uncertain event.⁵⁰ In this regard, a determinable gift “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”.⁵¹

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.⁵² Where there is a gift over, lawyers should ensure that the gift over is to another charity rather than a non-charitable entity. Otherwise, that portion of the gift will no longer qualify as charitable and the donor will not be entitled to claim any income tax credits or deductions with respect to the gift.

49. *Op. cit.*, footnote 46, at pp. 146, 150.

50. *Ibid.*, at p. 142.

51. Picarda, *op. cit.*, footnote 45, at pp. 278-279.

52. *Op. cit.*, footnote 48.

C. What Provisions Should Be Considered When Drafting Restricted Charitable Purpose Trusts?

It is important to remember that failure to comply with the terms of a restricted charitable purpose trust could result in the board of directors being found in breach of trust and exposed to personal liability. Accordingly, lawyers must carefully consider what provisions to include when drafting testamentary and *inter vivos* restricted charitable purpose trusts, taking into consideration the need to ensure both the validity of the trust, as well as the legal and moral implications of the trust. This section of the article will highlight some of the more important issues that lawyers should consider when drafting the specific terms of restricted charitable purpose trusts.⁵³

(1) Initial Considerations Involving Endowment Funds

Frequently, lawyers will be asked by their clients to draft an endowment in some form. However, the client, whether it be a donor or a charity, will often not be sure what they mean in requesting an endowment. Lawyers therefore, need to be careful before using the term endowment when drafting restricted charitable purpose trusts. The fact is that “endowment” is not a *legal* word.⁵⁴ Rather, it is a term of art that is most often used by charities and donors to indicate an intention that the capital of a restricted purpose charitable trust fund is to be held “in perpetuity”. However, the word “endowment” has also been used in recent years to refer to trusts where the capital is to be retained for a minimum period of 10 years in the form of a 10-year gift pursuant to the disbursement quota rules that were in existence prior to the 2010 Budget reform rather than requiring that the capital of the trust be held in perpetuity. Usage of the term “endowment” in this context, *i.e.* of establishing 10-year gifts, has caused significant confusion with donors to date.

As a result, the words that are used in establishing a restricted charitable purpose trust need to carefully reflect what the donor actually wants and what the charity is prepared to accept. Specifically, donors and charities should only use the term “endowment” where it is intended that the capital is actually to be held in perpetuity, in which event the restricted charitable purpose

53. See Terrance S. Carter, “Effectively Structuring Endowment Agreements” (October 1, 2009), online: <http://www.carters.ca/pub/seminar/charity/2009/tsc1001_files/frame.htm>.

54. See Malcolm D. Burrows, “The End of the Endowments?” (2010), Vol. 23, No. 1, *The Philanthropist*, at p. 54.

trust should be called a “perpetual endowment” to be absolutely clear regarding what is intended. With gifts where the capital is to be held for some specific period of time, but not in perpetuity, those gifts should be called “long term funds” or by some similar terminology, as opposed to a “perpetual endowment”.

In this regard, it is important to recognize that not every charity actually wants to receive a perpetual endowment because of the difficulty in administering those funds into the future and the concern that circumstances in the future may require that the capital of such funds be expended. Even when a charity is prepared to accept a perpetual endowment, the charity will normally only be interested in receiving such type of gift if there is the inclusion of a provision giving the charity the ability to encroach on the capital under certain special circumstances, such as meeting the disbursement quota, or in response to extenuating circumstances as may be determined by the board of the charity from time to time. This last point is an important consideration that legal counsel should carefully discuss with the charity or donor before drafting a restricted charitable purpose trust that is intended to create a perpetual endowment in order to ensure that the charity and the donor both fully understand the difference between a perpetual endowment with no ability to encroach, a perpetual endowment with the ability to encroach, and a long-term fund where the capital of the fund will be expended by a particular date.

(2) Thresholds in Establishing a Restricted Charitable Purpose Trust

The charity should consider whether it will require a minimum amount in order to accept a restricted charitable purpose trust. For example, if a donor would like to create a restricted charitable purpose trust with a gift of \$5,000.00, the charity should consider the cost to the charity that will be spent in administering that trust. As well, the charity will want to consider whether further contributions of capital to the restricted charitable purpose trust will be permitted, and if so, whether there should be any limitations imposed on these further contributions, such as who may make contributions and whether a minimum donation will be required. Prior to the 2010 Budget changes discussed above, charities would have had to structure additional contributions to the capital of long-term charitable purpose trust funds as separate 10-year gifts in order to comply with the enduring property exemption requirements in the *ITA*, which resulted in significant administrative burdens for the charity. However, with the repeal of the 80% disbursement quota and

10-year gift requirements for enduring property, charities are now able to structure restricted charitable purpose trusts to receive additional capital contributions on an ongoing basis.

(3) Description of Restricted Purpose

The donor and the charity must ask what the restricted purpose of the charitable purpose trust is, and whether such restricted purpose is to be permanent, or whether variations to the restricted purpose should be permitted. If the restricted purpose is intended to be permanent, it must be sufficiently general in order to meet the test of time and changing circumstances. However, the charity must consider what will happen to the restricted charitable purpose trust when the intended restricted purpose has been achieved, is no longer relevant, or is no longer practical. As a result, it is generally advisable to include a provision permitting the charity to vary the restricted purpose in the discretion of the board of the charity in order to avoid having to seek a *cy-près* order from a court to do so.⁵⁵ Variation of the restricted purpose of the trust is discussed in more detail below.

With regards to the specifics of the restricted purpose, as explained earlier in this article, it is possible to include restrictions dealing with time, such as a restriction to hold the gift over a number of years, or in perpetuity (normally subject to some type of right to encroachment), or a restriction on use, such as a scholarship, or combination restriction (*i.e.*, a perpetual endowment with the income to be used for medical research). Determining which restrictions are appropriate and how broadly or narrowly to word these restrictions will require careful drafting, often involving consultation with both the charity and the donor where possible.

(4) Assets Forming the Trust

The charity must consider what assets the restricted charitable purpose trust will consist of. For instance, will the trust consist of moneys or gifts in kind, such as shares? Different types of property will have to be handled differently by the charity. For example, if the trust involves a gift of shares, the charity needs to ensure that there is a proper evaluation of the shares done in advance of the gift. Gifts of publicly traded shares will be exempt from capital gains tax, but not gifts of private shares.⁵⁶ As well, whether the gift consists of cash or a

55. Elizabeth Moxham, "Endowments 2.0: Rethinking Endowments in the New World" in *Gift Planning in Canada*, Vol. 15, No. 5 (May 2010).

56. *Income Tax Act*, *supra*, footnote 5, para. 38(a.1). For more detail see Terrance S. Carter, "An Overview of Capital Gains Tax Exemptions as a

gift in kind such as shares, it is important for both the donor and the charity to give consideration to whether the split receipting and anti-tax shelter provisions of the *ITA* could affect the fair market value of the gift for receipting purposes, either through the deduction of an “advantage” from the fair market value of the gift, or the reduction of the fair market value of the gift through the deeming provision applicable to some specific types of gifts in kind.⁵⁷

(5) Naming Rights

Some donors may wish to build naming rights into the terms of the trust. If so, the charity must determine how long the naming rights will extend for. A Charity charity must also decide whether it wishes to reserve the right to terminate the naming rights of a donor, and under what circumstances it can do so.

Both the donor and the charity may also need to consider whether the naming rights might be considered to constitute a taxable “advantage” under the *ITA*. The position of CRA is that individual naming rights on their own do not constitute an advantage that would prejudice the ability of the donor to obtain a tax receipt for the full value of the gift.⁵⁸ However, for a business, if the naming rights amounted to a form of sponsorship which promoted the brand or the products of the business, then the naming rights could very well constitute an advantage that would need to be deducted from the fair market value of the gift. However, the business would then be able to deduct the value of such advantage as a business expense and would be in the same tax situation as if the full amount of the gift was receipted.⁵⁹

Philanthropic Incentive in Canada” (presented for the Australian Centre for Philanthropic and Nonprofit Studies *Modernising Charity Law Conference*, Brisbane, 2009).

57. For more information on the application of the split-receipting rules and anti-tax shelter provision of the *ITA* see M. Elena Hoffstein and Theresa L.M. Man, “When Is an Advantage Not an Advantage — Issues Arising From the Proposed Split Receipting Regime” (presented for the Canadian Bar Association and the Ontario Bar Association *4th National Symposium on Charity Law*, Toronto, May 2006); and also Theresa L.M. Man, “Recent *Income Tax Act* Amendments That Affect Charities” *Charity Law Bulletin* No. 221 (July 29, 2010), online: <<http://www.carters.ca/pub/bulletin/charity/2010/chylb221.pdf>>.

58. Canada Revenue Agency, *op. cit.*, footnote 42.

59. Theresa L.M. Man, “Corporate Giving: A Tax Perspective” (September, 2006) online: <http://www.carters.ca/pub/article/charity/2007/tlm_corpgiving.pdf>.

(6) Disbursing Trust Funds

One of the most difficult issues to deal with in drafting a restricted charitable purpose trust is to determine on what basis trust funds are to be disbursed in accordance with the terms of the restricted charitable purpose. If there is no restriction as to time, then the charity will generally disburse funds received together with any short-term interest earned as soon as it is practical. However, where there is a time restriction, such as with a long term or perpetual endowment, the question becomes whether all of the income earned is to be expended on the restricted purpose, or if only a portion is to be expended with the balance being capitalized, presumably in order to keep up with inflation.

Another issue that may need to be addressed is whether the income to be disbursed is to include interest and dividend income only or whether it is also to include realized capital gains. In this regard, the charity might want to consider utilizing a total return investment model where the charity is directed to treat all returns from the fund as expendable on an annual basis, whether derived from interest, dividends, or capital gains.⁶⁰

Whatever preference a charity has toward these issues, it is generally better to have the charity clearly articulate them in its own disbursement policy that it can then amend from time to time and have the terms of that disbursement policy then incorporated by reference into the trust document instead of leaving it to be worked out within the terms of the trust document itself or leaving it up to the direction of the donor.

(7) Donor-Advised Provision

Another consideration is whether the donor wishes to retain some input into the disbursement of the trust funds as a “donor-advised fund”. As discussed earlier in this article, in such cases, the donor will retain the ability to provide non-binding advice with regards to how the capital and income of the gift will be used. However, it should be made clear to the donor that the board of the charity must ultimately exercise its discretion over the expenditure of the income and capital of the gift. As indicated previously, too much control by the donor will defeat the gift and will result in the donor being unable to have the

60. Malcolm D. Burrows, *op. cit.*, footnote 54, at pp. 54, 58. See also *Killam Estate v. Dalhousie University* (2000), 38 E.T.R. (2d) 50, 185 N.S.R. (2d) 201, 97 A.C.W.S. (3d) 1287 (S.C.) and *Toronto Aged Men's And Women's Homes v. Loyal True Blue and Orange Home* (2003), 68 O.R. (3d) 777, 5 E.T.R. (3d) 260 *sub nom. Stillman Estate (Re)*, 128 A.C.W.S. (3d) 200 (S.C.J.).

gift receipted for income tax purposes and possibly even challenged on a subsequent audit of the donor's charitable gifts by CRA.

(8) Administration Fee

Another issue to consider in drafting a restricted charitable purpose trust is whether the charity wishes to be allowed to charge a reasonable administrative charge against income and/or capital of the trust fund. If so, the charity should either reflect the details of the administrative charge in the trust document itself, or the charity should require a cross-reference in the trust document to the gift acceptance policy of the charity that would set out a reasonable administrative fee that would be charged against the income and/or capital of the trust funds.

(9) Investing Trust Moneys

When drafting a restricted charitable purpose trust, lawyers should become familiar with the investment policy of the charity (if there is one), since such policy will normally determine how the capital of the restricted purpose charitable trust will be invested. In Ontario, the *Trustee Act* requires that there be an investment policy if investment decision-making is delegated.⁶¹ Although it is not a requirement that there be an investment policy where there is no delegation of investment decision-making, it is still advisable for a charity to consider adopting an investment policy. A well-drafted investment policy will help protect the board of directors from personal liability, and it will also assist in ensuring that the board of directors has addressed the statutory requirements in the *Trustee Act* (Ontario).⁶²

The standard of care by which trustees, including charities with regards to charitable property, must adhere to when investing trust moneys has been implemented by statute in every Canadian jurisdiction.⁶³ In Ontario, the *Trustee Act* states that "a trustee must exercise the care, skill, diligence and judgment that a prudent

61. *Trustee Act*, R.S.O. 1990, c. T.23, at s. 27.1(2).

62. For more information see Terrance S. Carter, "Considerations in Drafting Investment Policies in Ontario" in *Charity Law Bulletin*, No. 207 (April 29, 2010), online at: <<http://www.carters.ca/pub/bulletin/charity/2010/chylb207.htm>>.

63. Terrance S. Carter, "Investment Powers of Charities and Not-for-Profits Under Ontario's *Trustee Act*" in *Charity Law Bulletin*, No. 192 (February 25, 2010), online at: <<http://www.carters.ca/pub/bulletin/charity/2010/chylb192.htm>>.

investor would exercise in making investments”.⁶⁴ This means that trustees are free to invest in any form of property they wish, so long as it is one in which a prudent investor would invest. A trustee’s investment decisions will be viewed objectively to determine if the standard is met. If an investment were to perform poorly, or lose money, the trustee would not be liable for the loss if he or she is able to demonstrate that the investment was made according to a reasonable assessment of risk and return that a prudent investor would make under similar circumstances.⁶⁵ Charities will generally want to incorporate by reference to their investment policies into the trust document, or alternatively the charity might be prepared to allow the donor to impose specific investment terms of reference on the gift, although the former is preferable. Where the donor does impose specific investment terms the charity will need to ensure that they are consistent with the “prudent investor” standard set out in the *Trustee Act* (Ontario), its existing investment policy, as well as its charitable purposes, before accepting.

(10) Variation of the Trust

At the outset, it is important to remember that the donor cannot vary the terms of the charitable trust after it has been created, although as stated above, the donor can retain the ability to provide non-binding input through a donor-advised provision as part of the terms of the trust. As well, as stated earlier in this article, the charity has no authority to vary the terms of a charitable trust on its own unless the document creating the restricted charitable purpose trust permits the charity to modify the terms of the trust. As such, it is essential that the trust document include a provision that permits the charity to vary the terms of the restricted purpose at the discretion of the charity, whether such restriction deals with restrictions involving use or time. The lawyer needs to ensure that the charity is given the maximum amount of flexibility in this regard as possible.

(11) Transfer of Trust Property

Another important provision to consider including in the trust document is one that provides the charity with the ability to transfer the trust funds to a subsequent trustee, provided that the subsequent trustee is a registered charity and will enter into a deed of appointment as contemplated by s. 3 of the *Trustee Act* (Ontario). The deed of

64. *Supra*, footnote 61, at s. 27(1).

65. Terrance S. Carter, *op. cit.*, footnote 63.

appointment will ensure that the recipient charity agrees to be bound by all of the terms of the original restricted charitable purpose trust as a subsequent trustee pursuant to s. 3 of the *Trustee Act* (Ontario). If the recipient charity is not at arm's length to the transferor charity, then the transferor charity will want to record the transfer as a "designated gift" in its T3010B in order to avoid the recipient charity being required to spend 100% of the transferred property by the end of the following taxation year in accordance with the proposed new anti-avoidance provisions contained in the 2010 federal Budget proposals.⁶⁶

(12) Return of the Gift

A charity, when accepting a gift by means of a restricted charitable purpose trust, may want to consider whether it should expressly reserve the right to refuse or even return the gift. If it wishes to reserve this right, it will need to consider under what circumstances it will do so. Some examples are where the donor has been criminally convicted, has exhibited immoral conduct, or the charity has concerns about the donor being involved in terrorist activity.

Where the charity is in a situation where the return of a gift is necessary, the charity will first need to correct the previously issued charitable receipt. In this regard, the charity would need to issue a replacement receipt which would be for "nil" or the reduced value of the gift. It would also need to file adjustments to the charity's T3010B Information Return for the affected year, thereby reducing the amount of receipted donations listed on line 4500 of the return. Such adjustments would be filed using Form T1240 *Registered Charity Adjustment Request*.⁶⁷ The charity also needs to inform CRA when it returns a gift with a letter disclosing the refund, the reason for the refund, and attaching a replacement receipt.⁶⁸

66. The stated purposes of the anti-avoidance provisions are to ensure that charities do not enter into transactions which are meant to avoid or unduly delay the expenditure of amounts on charitable activities in accordance with the disbursement quota requirements, as well as to ensure that inter-charity transfers between non-arms length charities will be used to satisfy the disbursement quota of only one charity. For more information on the 2010 federal Budget, see <<http://www.budget.gc.ca/2010/plan/toc-tdm-eng.html>>.

67. Kate Lazier and Andrew Valentine, "Considerations Involved with the Return of a Gift" (presented at the 2010 National Charity Law Symposium, April 30, 2010).

68. While there is no statutory requirement to report refunded donations to CRA, CRA has taken the administrative position that it expects to be

(13) Anti-Terrorism Considerations

As well, charities may also need to consider addressing due diligence considerations under Canada's broad reaching anti-terrorism legislation. The terms of that legislation can significantly impact charities, particularly those charities operating outside of Canada in conflict zones. Accordingly, the charity may need to take appropriate steps to ensure that it conducts the necessary due diligence inquiries of the donor.⁶⁹ The charity may also want to consider retaining a discretion in the trust document *not* to apply the trust moneys to the restricted purpose in the event of anti-terrorism concerns as determined in the discretion of the charity.

(14) Independent Professional Advice

Finally, before accepting a gift that is subject to a restricted charitable purpose trust, a charity should consider advising the donor in writing to seek independent legal advice and/or tax advice from an accountant or financial planner. Donors should be informed of this right *before* the gift has been made and to have it confirmed in the trust document. Doing so will help reduce the risk of a gift subsequently being challenged by the family of the donor due to allegations of undue influence. In this regard, the charity should be aware of any other evidence of undue influence apparent in the donor's actions, and should appropriately address any concerns about undue influence before the gift has been made.

(15) Considerations When Drafting Board-Created Restricted Charitable Purpose Trusts

When considering what terms to include in a board-created restricted charitable purpose trust to which donors would be invited to make contributions, the substantive terms of the trust should generally be similar to the terms of a donor-created trust as described above, and therefore should be as carefully drafted as the terms of a testamentary or *inter vivos* charitable trust.

Additionally, boards should be careful to ensure that they adopt a

informed where a charity returns a gift. See Canada Revenue Agency, *supra*, footnote 48.

69. For more information see <www.antiterrorism.ca>. See also Terrance S. Carter, Sean S. Carter, and Nancy E. Claridge, "The Impact of Anti-Terrorism Legislation on Charities in Canada: The Need for an Appropriate Balance" (October 26, 2007), online at: <<http://www.carters.ca/pub/article/charity/2007/tsc1026.pdf>>.

board resolution to authorize the restricted charitable purpose trust when establishing the terms of the fund. In fact, there should be a board resolution to authorize each separate board-created trust or alternatively, there should be a board resolution to delegate that ability to an authorized officer of the charity. Lastly, to reduce the risk that the restricted charitable purpose trust will be challenged, the board should take steps to ensure that the terms of the trust have been adequately communicated to the donor in writing.

D. Conclusion

Before drafting a restricted charitable purpose as either a testamentary or *inter vivos* trust, it is important to understand what a charitable purpose trust is, as well as the duties and obligations that boards of directors of charities have in terms of managing and investing the funds that are subject to a charitable trust. As well, drafting restricted charitable purpose trusts necessitates an understanding of the restrictions that can be applied, since there can be significant legal consequences associated with different restrictions that the charity and the donor will need to be aware of before such restrictions are included in the terms of the trust.

Many donors prefer making gifts that are subject to restricted charitable purpose trusts because it allows them to retain some measure of control over their gift, and provides better assurance that their philanthropic objectives will be advanced. By contrast, charities usually prefer receiving unrestricted gifts, since restricted gifts may involve significant legal and administrative burdens for the charity. Regardless of their presence however, restricted charitable purpose trusts are at present and will continue to be an important part of fundraising for charities. Moreover, given the increased demands on fundraising by 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 restricted charitable purpose trusts will continue to be an important aspect of funding for charities in the future. For these reasons, lawyers advising charitable clients and donors need to be aware of the legal duties and resulting consequences associated with establishing restricted charitable purpose trusts. It is hoped that this article will help in this regard.