
CY PRES GRANTED TO ENABLE CHARITABLE TRUST TO MEET DISBURSEMENT QUOTA

*By Terrance S. Carter, B.A., LL.B., Trade-mark Agent
and Nancy E. Claridge, B.A., M.A., LL.B. Candidate*

A. INTRODUCTION

In *Toronto Aged Men's and Women's Homes v. Loyal True Blue and Orange Home* (2003), 68 O.R. (3d) 777, [2003] O.J. No. 5381 (the "Toronto Aged Men's and Women's Homes case"), the Ontario Superior Court of Justice exercised its inherent jurisdiction to alter the terms of a charitable trust (the "Trust") to address the Trust's inability to meet its disbursement quota due to the rate of return on its capital assets. Coincidentally, the difficulties of charities meeting their disbursement quota was addressed in the March 23, 2004 Federal Budget (the "2004 Federal Budget"),¹ which proposed several changes to the disbursement quota for charities, including a reduction from 4.5 percent to 3.5 percent per year on capital assets held by charitable foundations (to be extended to all registered charities), in order to more closely represent historical long-term real rates of return on the typical investment portfolio held by charities. This proposed change to the *Income Tax Act* ("ITA") will apply to tax years that begin after March 22, 2004. Draft legislation to implement the 2004 Federal Budget was introduced by the Federal Government on September 16, 2004.

¹ For more information on the March 23, 2004 Federal Budget, please see *Charity Law Bulletin No. 41* (30 March 2004), available at www.charitylaw.ca.

Notwithstanding the proposed reduction in the disbursement quota, charities will likely continue to face difficulties in meeting their disbursement quota from time to time. This *Charity Law Bulletin* discusses the findings of the Toronto Aged Men's and Women's Homes case and resulting implications in relation to ensuring the terms of a charitable trust are sufficiently broad in order to enable trustees to operate effectively and in compliance with the disbursement requirement of the ITA.

B. FACTS OF THE CASE

A Trust created by the Will of Mary Elsworth Stillman (the "Testatrix" or "Stillman"), amounting to \$3,464,075 on death in 1961 and \$19,306,466 on June 30, 2001, contained terms requiring the capital to be set aside and kept invested, with the net income paid out to two charitable beneficiaries. The Trust was intended to be a perpetual endowment, with Stillman expressing a preference for investments in equities in order to protect the value of the residue against the effects of inflation. This was achieved to an extent by the investment policy adopted by the trustee in accordance with Stillman's intentions, with an approximate 10 percent loss of purchasing power by 2001, and a further six percent loss between June 30, 2001 and June 30, 2002 due to the decline in share prices. The combined effect of the investment strategy and the absence of any authority to distribute capital resulted in the Trust's inability to meet its 4.5 percent disbursement quota for the fiscal years ended June 30, 1997 through June 30, 2002, instead only averaging 3.4 percent to 4.1 percent of the value of its investment property for those years. The court indicated that the disbursement quota was calculated as 4.5 percent of the average fair market value of the investment property in the immediately preceding 24-month period, pursuant to the ITA. The cumulative shortfall was \$738,000, potentially exposing the Trust to having its charitable registration revoked, and liability for a revocation tax. Although the Minister's discretion under s. 149.1(5) of the ITA to reduce a charity's disbursement quota is referred to in the decision, no explanation of whether the Trust had applied for such a reduction of the disbursement quota, which would likely have been granted, was provided.

The trustee and charitable beneficiaries applied to the court for approval of a scheme for the administration of the Trust that would permit the trustee to diverge from the directions in the Will and adopt a "total return" investment and distribution policy. Under a total return investment policy, the best returns of income and capital gains are sought without distinguishing between them. While the respondent, The Loyal True Blue and

Orange Lodge, whose interest was contingent on the termination of the trust for the charitable beneficiaries, consented to the order requested, the Public Guardian and Trustee (the “PGT”) submitted that the court should not grant its approval of the scheme as formulated, but took the position that the PGT would not oppose more limited relief that would alleviate the problem, justifying a departure from the terms of the Will.

The central issues in the application were whether the court had jurisdiction to give its approval, and whether such jurisdiction should be exercised in the manner requested.

C. FINDINGS OF THE COURT

The applicants in the Toronto Aged Men’s and Women’s Homes case proposed a scheme that would override the Testatrix’s intention that the capital be retained and kept invested and only have the income distributed. The court had difficulty accepting the proposition that the Testatrix’s directions be ignored on the ground that it is expedient or desirable because the Trust would be more efficiently administered without them. In so doing, the court distinguished the case of *In re J.W. Laing Trust*, [1984] Ch. 143 (Ch.D.), wherein the English Chancery Division approved a departure from the terms of a trust, which did not create an endowment, affecting the timing of distributions of capital. However, the court noted that the terms of a charitable trust may be varied when the conditions for an application of the *cy pres* jurisdiction are satisfied, namely that the purposes of the Trust have become impossible or impracticable to achieve if it is to continue to be administered in accordance with the provisions of the Will.

1. Cy Pres Jurisdiction Exercised

“*Cy pres*” is the equitable doctrine under which a court changes a written instrument, such as a trust, with a gift to charity “as closely to the donor’s intention as possible,” so that the gift does not fail. In this case, such a variation would involve a departure from the intentions of the Testatrix and would override her express directions in the Will. The court held that its jurisdiction would permit the authorization of encroachments on capital to the extent required to satisfy the Trust’s disbursement quota.

Accepting that the combined effect of the investment strategy and the absence of any authority to distribute capital resulted in the Trust's inability to meet its disbursement quota in successive years, and the potential for serious consequences should this continue, the court concluded that the administration of the trust in accordance with Stillman's intentions was no longer practicable and that a *cy pres* order was appropriate to rectify the problem. According to the court, the existence of the Minister's discretion, under s. 149.1(5) of the ITA to reduce the disbursement quota was not sufficient to make the purposes of the trust practicable in these circumstances. Consequently, as the administration of the trust in accordance with the terms of the Will jeopardized the Trust's status as a charity, it was sufficient to constitute an impracticability that justified the exercise of the court's *cy pres* jurisdiction.

The total return approach proposed by the applicants was found to provide a degree of flexibility that should enable an increase in the return from investments and thereby protect the Trust's purchasing power or real value, notwithstanding the fact that distributions of capital may be made. This was likely to accommodate the overall intentions of the Testatrix with respect to both investments and distributions to a greater degree than an order authorizing encroachments on capital from time to time. The scheme proposed by the applicants for investments and distributions in accordance with the total return model was approved, with some modifications including fixing the distribution rate at 4.25 percent.

2. Disbursement Quota Alleviation Required

Despite the stated position of the Canada Revenue Agency (the "CRA") to not revoke charities whose failure to meet their disbursement quota was directly attributable to the current low interest rates requiring affected charities to request an alleviation pursuant to s. 149.1(5) of the ITA, the court did not regard it as sufficient to justify inaction on the part of the court as far as the future administration of the Trust was concerned. However, in order to address the accumulated shortfall, the court directed the trustee to make such a request to the CRA.

3. PGT and Attorney General Authority

Addressing submissions made by the PGT, the court refused to extend the authority of the Attorney General, and by extension that of the PGT, to make it necessary to obtain their consent before the court could exercise its jurisdiction to approve a proposed variation of the terms of a charitable trust saying, “the inherent jurisdiction is that of the court and not that of the Attorney General or the Public Guardian and Trustee.” Instead, the Attorney General cannot act except with the authority of the court.

D. IMPLICATIONS OF THIS CASE

In the current investment climate, it is inevitable that many charities will be unable to achieve real rates of return sufficient to satisfy the disbursement quota required under the ITA. Without the legislation required to implement changes proposed in the 2004 Federal Budget, charities will continue to face potentially severe penalties for innocent failures to comply with the ITA. Still, the proposed changes announced in the 2004 Federal Budget will not resolve all issues. Accordingly, charities, their boards of directors, donors, and their advisers should note several points made by the Toronto Aged Men’s and Women’s Homes case:

- Charitable trusts should be drafted in such a manner as to enable trustees to generally conform to donor intentions, yet still adjust investment policies in accordance with the fluctuating market. This would likely include the power to encroach on the capital to meet the Trust’s disbursement quota in the event that relief under section 149.1(5) of the ITA is not available;
- Charities must be proactive in addressing disbursement problems arising from the terms of a charitable trust, seeking relief from the CRA under subsection 149.1(5) of the ITA or the courts where appropriate;
- Courts will be unwilling to alter the terms of a charitable trust solely on the grounds that it would be more efficiently administered without them, or that it is expedient or desirable; and
- Consent from the PGT is not technically necessary in order to obtain a *cy pres* order from the court.

However, while it is not necessary to obtain consent from the PGT to support an application for a *cy pres* order, in practice it would be prudent to do so if possible. If no other interested party objects, it may be possible to obtain a consent order from the PGT under section 12 of the *Charities Accounting Act* without having to apply for a formal court order.

E. CONCLUSION

Despite proposals by the federal government to reduce the disbursement quota in the 2004 Federal Budget, charities and their boards of directors need to be vigilant in effectively and appropriately managing charitable trusts in order to ensure compliance with applicable disbursement quotas. This should include monitoring of the Trust's ability to meet the needs of the disbursement quota, and taking appropriate measures through the CRA or the courts should shortfalls occur. Looking forward, there is a need to educate donors and their advisors to construct trusts in a flexible manner to ensure trustees can react to the market fluctuations accordingly, without costly resort to the courts.

CARTERS.ca**CARTER & ASSOCIATES**
PROFESSIONAL CORPORATIONBARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with **Fasken Martineau DuMoulin** LLP**Main Office Location**211 Broadway, P.O. Box 440
Orangeville, ON, Canada, L9W 1K4
Tel: (519) 942-0001
Fax: (519) 942-0300

Toll Free: 1-877-942-0001

www.carters.ca**National Meeting Locations**

Toronto (416) 675-3766

Ottawa (613) 212-2213

London (519) 937-2333

Vancouver (877) 942-0001

"Proactive Advice"®

www.charitylaw.ca

DISCLAIMER: This is a summary of current legal issues provided as an information service by Carter & Associates. It is current only as of the date of the summary and does not reflect subsequent changes in the law. The summary is distributed with the understanding that it does not constitute legal advice or establish the solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2004 Carter & Associates