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CREATING ENFORCEABLE PLEDGE AGREEMENTS

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A. INTRODUCTION

Donors often make gifts in an indirect or deferred fashion that is best suited to his or her ability and estate plan. Charities are naturally very grateful for such intended donations, and may even access promised funds immediately by borrowing against such a pledge. However, in some instances the donor passes away before the entire donation can be made, and may not have amended his or her will to reflect the promised donation. The donor's executors are bound by a duty to preserve the assets of the estate for the beneficiaries and may be unwilling to honour the pledge on the basis that a mere promise to make a gift in the future is not enforceable at law, leaving the charity without the donation it had expected and relied upon and the donor's charitable intentions unrealized. This was the result in the recent Ontario case of *Brantford General Hospital Foundation v. Marquis Estate*[1], but is not necessarily unavoidable. This *Charity Law Bulletin* ("Bulletin") will discuss *Brantford Hospital* and the possibility of creating legally binding pledge agreements.[2]

The issue is complex because there are two authorities, each with different requirements which must be satisfied, and these requirements are contradictory and conflicting in certain respects. The first authority is the

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[1] (2003), 67 O.R. (3d) 432 (Sup. C.J.) ("Brantford Hospital").
[2] Reproduced with permission. Previously published by Canadian Bar Association of Ontario, *Deadbeat*, October, 2004, and Fasken Martineau DuMoulin LLP, *Charities and Not-for-Profit Law Bulletin*, November 2004.

common law, the various requirements of which must be satisfied in order to create a contract which the Courts will enforce. The second authority is the Canada Revenue Agency and the various requirements of the *Income Tax Act* which must be satisfied in order for the donation to be construed as a gift and thus be eligible for the tax incentives available for charitable gifts.

Two fundamental conflicts between the requirements of these authorities are (a) for a contract to be enforceable by the Courts, it must provide a benefit, or consideration, to both parties, but a gift, by definition, must be made without the expectation of benefit, and (b) if a person is legally obligated by law to make a payment, then the payment is not a gift, because gifts must be made voluntarily.

Notwithstanding this difficulty, as discussed more fully below, it may be possible to create an enforceable pledge agreement by creating a legally binding contract through the use of nominal consideration, such as a small sum of money, a token or other benefit which CRA considers to be of nominal value, such as naming rights. This will create a binding obligation at law without creating a benefit back to the donor. Though this does not resolve the issue that the payment subsequently made pursuant to such a binding contract, or a court order enforcing it, may not be considered voluntary, CRA has made statements that give comfort on this issue.

It may also be possible to rely on the equitable remedy of estoppel based on past performance and/or detrimental reliance, rather than contract, which will allow the Courts to enforce the donor's promise to pay, despite the fact that the pledge agreement is not otherwise enforceable at law. This option is more difficult and uncertain however, as the tests of equity are more antiquated and by their nature, more flexible and subject to the Court's interpretation than the tests of law.

B. ENFORCEABILITY REQUIRES CONSIDERATION

Brantford Hospital deals squarely with the enforcement of a promise to make a future donation to a charity. About a year prior to her death in 2000, Mrs. Marquis, a lifelong supporter of the Brantford General Hospital Foundation, signed a $1 million pledge to the Foundation's capital campaign, payable over five years. She paid the first instalment of $200,000 in April 2000, but died the following month. Mrs. Marquis left the

Foundation a bequest of one-fifth of the residue of her estate, but the Estate Trustees refused to pay the remaining $800,000 on the pledge and the Foundation sued to enforce the pledge.

The case before the Ontario Superior Court of Justice turned on whether there was sufficient consideration between the Foundation and Mrs. Marquis to make the pledge a binding contract. The Foundation argued that the fact that the naming of the new critical care unit at the Hospital for Mrs. Marquis and her late husband was sufficient. The court disagreed, because Mrs. Marquis "never sought the naming of the unit as a condition for making the pledge." The Court found that the naming opportunity was irrelevant to Mrs. Marquis, and had been suggested by the Foundation. The Court also found that because the decision to name the unit in honour of the Marquis's was still subject to board approval, it could not constitute bona fide consideration. In reaching this conclusion, the court distinguished the New York Court of Appeals' decision in *Allegheny College*[3], in which the Court found a naming right attached to a pledge to be sufficient consideration to create a bilateral agreement.

The court in *Brantford Hospital* may have reached a different conclusion had Mrs. Marquis insisted on the naming of the unit to which she was donating as a condition of the donation, or if the pledge document between her and the hospital been drafted differently, or made under seal, though this cannot be stated with certainty. It is clear however, from this and numerous other cases, that any agreement which merely documents a proposed gift will not be enforceable at law.

C. GIFTS MUST BE MADE WITHOUT EXPECTATION OF RETURN

Both the common law and Revenue Canada agree upon the definition of a gift; a is a voluntary transfer of property without valuable consideration. CRA has stated that generally, a gift is made if all of the following conditions are met[4]:

1. some property is transferred by a donor to a registered charity;
2. the transfer is voluntary; and

[3] *Allegheny College v. National Chautauqua County Bank of Jamestown*, 2246 N.Y. 369, 159 N.E. 173 (N.Y. C.A.).
[4] Canada Revenue Agency, Interpretation Bulletin IT-110R3, *Gifts and Official Donation Receipts* (June 20, 1997).

3. the transfer is made without expectation of return. No benefit of any kind may be provided to the donor or to anyone designated by the donor, ***except where the benefit is of nominal value***.

Where a charity offers an item, privilege or other benefit in return for a donation, CRA has set a *de minimis* threshold which provides that a benefit is generally considered to have a nominal value where the fair market value of the advantage received by the donor does not exceed the lesser of 10% of the value of the gift and $50.00[5]. Such benefits of nominal value will not be regarded as advantages for purposes of determining whether a donation is a gift or in determining the eligible amount of the donation (there are certain exceptions and sub-rules to this general rule relating to, *inter alia*, tickets for dances and banquets, annuities, insurance and tuition fees). CRA has stated, however that "if you cannot establish the fair market value of a benefit, then we cannot consider it to be a benefit of nominal value."[6]

With respect to the issue of nominal consideration, there is a proposed new definition of "gift" under the *Income Tax Act*, announced December 20, 2002, and corresponding proposed rules regarding split-receipting, announced December 24, 2002[7], which will allow for greater than nominal consideration to flow back to a donor without jeopardizing the characterization of a donation as a “gift”. In contrast to the previous definition, the proposed amendments will permit a donor to receive a charitable tax receipt even though the donor receives a benefit of greater than nominal value, as long as the value of the property gifted exceeds the benefit received by the donor. In such cases, the value of the donation will be deemed to be the difference between the value of the property gifted and the value of the benefit back.

D. VALUE OF NAMING RIGHTS

CRA has stated clearly that the naming of a facility after a donor is not "providing an advantage" to the donor and that the value of naming rights is nil. In 1996 CRA issued its first ruling on the matter with regard to the naming of a municipally-owned facility after a corporate donor whose gift to the city was to be used to refurbish the facility. CRA stated that:

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[5] IT-110R3, *supra*.
[6] Canada Revenue Agency, Tax Advantages of Donating to Charity, RC4142E R02
[7] Canada Revenue Agency, *Registered Charities Newsletter*, No. 17 (1 January 2004). See Charity Law Bulletin, No. 23 (31 July 2003), *New CCRA Guidelines on Split-Receipting* for an explanation of Income Tax Technical News, No. 26 (24 December 2002). See also Terrance S. Carter and Theresa L.M. Man, *Recent Changes to the Income Tax Act and Policies Relating to Charities and Charitable Gifts* (4 March 2004).

"generally, in our view, naming a public owned facility or naming scholarships after the donor, should not, in and by itself, impair the gift status of a transfer."[8]

Subsequently, in 2003, CRA made a more unqualified statement in an advance income tax ruling on the issue, in a case involving a gift from a corporation and/or an associated individual to a charity for the purpose of acquiring and renovating premises for a school which would be named after the individual.

CRA stated:

> "Provided that there is no prospective economic benefit associated with the naming rights described in the Agreement, the amount of cash donated or the fair market value of the shares donated…by the Corporation to the Charity will qualify as a gift as described in paragraph 110.1(1)(a) … (and) it is our opinion that the amount of the advantage of such naming rights would be nil for the purpose of subsection 248(31) of the draft legislation released by the Minister of Finance on December 20, 2002."

Notably, in *Brantford Hospital*, the Court closely examined the issue of whether the naming of the facility after the donor was in fact a condition of the gift, suggesting strongly that if it had been, that it would have constituted sufficient consideration for the purpose of creating an enforceable contract at law.

E. GIFTS MUST BE VOLUNTARY

In order to retain the tax benefits associated with a charitable donation, the characterization of the donation as a "gift" is essential. For a donation to be considered a gift, there must be a voluntary transfer of property. This creates a potential problem for a charity seeking to create an enforceable pledge contract, because although it is likely possible to create an obligation that the Courts will enforce through the use of nominal consideration, in the event that the charity must resort to the Courts to enforce such an obligation, there is a possibility that CRA will look upon a payment made pursuant to a court order to be involuntary and therefore not a gift.

Some comfort is found in CRA's statement that:

[8] *Window on Canadian Tax Commentary*, document number 9613015 (September 24, 1996).

> "Generally, any legal obligation on the payor to make a donation would cause the donation to lose its status as a gift. However, when a taxpayer honours a personal guarantee concerning a loan made to a charity or honours a pledge, the amount can be considered to be a gift despite its having being (sic) paid to honour an obligation, if the obligation was entered into voluntarily and without consideration."[9]

Additionally, CRA has favourably cited an Australian Court of Appeal Case, *Leary v. Federal Commissioner of Taxation*, which held that although the property transferred to a charity must be transferred voluntarily and not as the result of a contractual obligation, a contractually binding promise to make a gift does not deprive it of its character.[10]

There have been instances where CRA has issued the opinion that a payment to a charity pursuant to a contractual obligation is not a gift where the contract is between the donor and a party other than the charity. For example, where the sole executors and beneficiaries of two separate estates are engaged in a dispute over certain property and one executor agrees to settle the matter and allow the other executor to have the property if he agrees to donate it to charity.[11] Or where a father, in the course of his estate planning, wishes to enter an agreement with his children obliging them to be philanthropic after his death.[12] In both of these examples, CRA stated that the payment would not be a gift because it would not be made from "detached and disinterested generosity", but rather from the requirement of the legal obligation.

Based on CRA's statements, it is likely that entering into a pledge contract involving nominal consideration will not defeat the requirement that there be a voluntary transfer of property, if the pledge is signed voluntarily.

In the event of a dispute between the charity and the donor, such that the charity was compelled to seek a court order to enforce the payment, the donor might insist that the payment was involuntary, however such an assertion is unlikely, because it would not affect the enforceability of the agreement and would only act to the donor's disadvantage due to the loss of the tax benefits associated with payment's characterization as a gift.

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[9] IT-110R3, *supra* at para. 9.
[10] Canada Revenue Agency, *Employee Speech*, CES-005 (February 3, 1999).
[11] *Window on Canadian Tax Commentary* Document number 9729335.
[12] *Window on Canadian Tax Commentary* Document number 9800525.

F. A FEW WORDS ABOUT ESTOPPEL

It is challenging to deal with the equitable remedy of estoppel briefly, due to the archaic and convoluted nature of the law in this area, however in *Brantford Hospital*, the Foundation made two unsuccessful arguments based in promissory estoppel.

The charity first made an argument using the equitable remedy of estoppel based on past performance. They argued that the donor ought not to be allowed to deny the existence of the contract, because she had in fact honoured the contract, at least in part, by paying the first instalment, as agreed. The Court rejected the charity's argument on this point, finding that the doctrine of estoppel would only apply if there was a pre-exiting legal relationship between the donor and the charity, which the Court found there was not.

In making this determination, the Court relied on *Reclamation Systems Inc. v. Rae*[13], which in turn relied upon the Supreme Court of Canada in *Conwest Exploration Co. v. Letain*[14], which considered the doctrine of promissory estoppel as set out in several earlier cases decided by the House of Lords. The doctrine is complex, however the Court in *Brantford Hospital* was less than exhaustive in it's discussion of the estoppel issues, and did not discuss its reasons for failing to find a pre-existing legal relationship, but rather muddled its brief discussion of past performance together with it's finding that there was no detrimental reliance and generally dismissed the equitable issues in a cursory manner, providing little guidance on the issue.

The foundation also argued that the donor's promise to pay should be enforced because the foundation had relied on the promise and would suffer harm if the promise is not fulfilled. This argument did not succeed in *Brantford Hospital*, because the Court rejected the Foundation's argument that it had relied on the pledge to its detriment. The Court found that the project had not yet begun at the time of the donor's death and that the Foundation intended to continue with the building project regardless of whether the pledge was honoured. Had the Court found evidence of detrimental reliance however, it is possible that it would have relied on equitable principles to enforce the payment obligation.

[13] (1996) 27 O.R. (3d) 419 (Gen Div.) at pp 450-457.
[14] [1964] S.C.R. 20, 41 D.L.R. (2d) 198.

G. CONCLUSION

In order to maximize the enforceability of the pledge contract, charities and their advisors should consider incorporating the following elements into their pledge agreements:

Nominal consideration from the charity to the donor;

1. the agreements should be signed under seal;
2. any naming rights should be stipulated as a specific condition of the payment of the donation in its entirety; and
3. an explicit statement in the agreement that the charity will rely, potentially to its detriment, on the donor's promise to pay, together with, to the extent possible, a description of the activities which will reflect such reliance.

Additionally, in order for a claim based in equity to succeed, it is important that the charity *in fact* rely to its potential detriment on the donor's promise to pay.

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