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LOOKING A GIFT HORSE IN THE MOUTH: WHAT TO DO WITH "BAD" DONATIONS

By Ryan M. Prendergast*

A. INTRODUCTION

The fallout from the recent recession brought the collapse of various investor or related fraud schemes to light. While unsuspecting investors must deal with the loss of investments or ongoing audits from Canada Revenue Agency ("CRA"), charities have also run into the dilemma of determining what to do with donations that have gone bad in this regard. For example, a university returned a $1-million gift from a donor and stripped his name from its business school when the former corporate executive pleaded guilty to corporate fraud, stating that the school felt its ethical credibility among students and their potential employers would be tainted if it kept the money and the donor's name. However, in a similar situation, a large hospital chose to keep the money as well as the name of another business executive who plead guilty to fraud. The president of the hospital foundation argued that removing the donor's name would have required using current donors' money to return the donation, and that helping patients is what donors' money should be used for and not other matters.

These donations illustrate the complexities faced by charities in similar situations. Directors of charitable organizations, who act as quasi-trustees,[1] must handle with care situations involving donated property that may have been fraudulently obtained.

* Ryan M. Prendergast, B.A., LL.B., is an associate of Carters Profession Corporation, Orangeville, Ontario, Canada.
[1] *Ontario (Public Trustee) v. Toronto Humane Society* (1987), 27 E.T.R. 40 (Ont. H.C.)

B. COMMENTARY

In order for the directors of the charity to fulfill their duty to act in the best interests of the charity, it may sometimes be incumbent upon the directors to protect the reputation of the charity to ensure that the charitable property is being used in furtherance of its charitable purposes. For example, it may be inconsistent to the purposes of some religious charities if they were to use monies to advance their charitable purposes once the charity has found that those funds had been obtained from innocent victims of fraud. This question, however, can become more difficult when the donor is not involved in fraudulent activities, but rather a wealthy philanthropist, whose money comes from a legitimate source, who may have received a criminal conviction not related to fraud or criminal breach of trust.

Charities may want to return a gift for moral reasons or in order to maintain credibility with members and donors of the charity. In this regard however, given that the court has *parens partriae* jurisdiction over charitable matters, a charity cannot unilaterally decide to return a gift in such situations. Courts of law in both the United Kingdom and Canada have held that the charity will have to obtain such permission from either the Attorney General, who in Ontario would be represented by the Ontario Public Guardian and Trustee ("PGT"),[2] or the courts of justice themselves.[3]

However, the far less expensive alternative to the courts would be to obtain written consent, for instance, from the PGT pursuant to section 13 of the *Charities Accounting Act* for a draft order or judgment that could have been made by the Superior Court of Justice dealing with or exercising its inherent jurisdiction within charitable matters, which is deemed to be an order or judgment of the court if both the PGT and all persons who would be required to be served in a proceeding to obtain that order or judgment consent. This allows a charity to apply to the PGT for approval for the return of a gift while avoiding a formal court proceeding. However, this can sometimes prove challenging where it is difficult to obtain the consent of all those who would be required to be served. In addition, the PGT may have concerns in providing its consent where the return of the gift may impoverish the charity, making it difficult for it to pursue its charitable purposes.

It is also important to contact CRA, since the return of the gift may have adverse tax consequences, particularly if the return will cause the charity to now have a disbursement quota shortfall in the previous

[2] *Re Stillman Estates* (2003), 5 E.T.R. (3d) 260
[3] *In re Snowden Dec'd* (1969), [1969] 3 W.L.R. 273, (Ch. D).

year (although less of a problem now because of the elimination of the 80% disbursement quota). In those circumstances, the charity may be required to submit a form T1240, *Registered Charity Adjustment Request*, to CRA to reflect the charity's changed financial position during the previous year(s).

In addition, given the characterization of charitable property as "trust" property, an aggrieved victim of the donor who was allegedly defrauded could commence an action to "trace" or "follow" the funds given to the charity and make a claim against any person that had deprived them of title. Professor Donovan Waters describes the distinction as follows, "the idea of tracking a particular asset as it moves from hand to hand can be called *following*, while the identification of exchange products or substitutes can properly be called *tracing*."[4] In this regard, an aggrieved investor could attempt to track their money into the hands of a charity and advance a claim against the charity for those funds.

However, such a claim would be frustrated when the property is acquired by a "*bona fide* purchaser for value without notice of the trust." Unfortunately, though, a charity is not normally considered a "*bona fide* purchaser for value" because no value has been given by the charity in return for the gift. In this regard, victims of fraud may be able to trace their money to the charity, and even if the gift was given to the charity some time ago and already spent, the victim, as a general principal, can claim that the charity's other monies had been spent and it is his or her money that remains.[5] The tracing claims may effectively end if the recipient charity can show that it did more than spend the money on its general charitable purposes but that the funds were applied or used up for a special project.[6]

Apart from the common law, a charity may be compelled to return its charitable property by statute. In this regard, subsection 462.37(1) of the *Criminal Code of Canada*, and, in the province of Ontario, the *Civil Remedies Act*, both provide a court with the authority required to have either "proceeds of crime" or property acquired via "unlawful activity" returned by the charity. However, these statutory remedies are only available when and if a civil action has been commenced or a criminal conviction or discharge is obtained. It is conceivable that neither may have occurred nor will ever occur. Indeed, in some instances the perpetrator

[4] Donovan Waters, ed., Waters' Law of Trusts in Canada, 3rd ed. (Toronto: Thomson Carswell, 2005) at page 1267.
[5] *Re Hallett's Estate* (1880), 13 Ch. D. 696 (Eng. Ch. Div.)
[6] *Diplock v. Wintle*, [1948] 1 Ch. 465, *(*sub nom. *Re Diplock)* [1948] 2 All E.R. 318 (Eng. C.A.); affirmed (1950), *(*sub nom. *Ministry of Health v. Simpson)* [1951] A.C. 251, [1950] 2 All E.R. 1137 (U.K. H.L.) at 530 [Ch.].

may have fled the jurisdiction or worse, is now deceased, and therefore no civil judgment or criminal conviction would be obtained.

C. CONCLUSION

Given the uncertainty surrounding the issues involved with "bad" donations as described above, it is always advisable to contact legal counsel should a charity encounter questionable donations or the charity is being asked to return a gift where the donor may have been involved in illegal activity. There may not only be legal hurdles for the board of directors to undertake, but also significant media relations challenges to address, as the public may complain when a charity is holding money that is now known to come from illegitimate funds. The proper management of the return of a donation is a challenging area of the law with no simple answers, as the course of action will be dependent on the particular facts of each situation.

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Ottawa (613) 235-4774
Mississauga (905) 306-2791
Orangeville (519) 942-0001
Toll Free: 1-877-942-0001
www.charitylaw.ca