
**THE REGION OF PEEL
AND THE “CARING FOR THE MORAINÉ” PROJECT PARTNERS**

**LEAVING A CONSERVATION LEGACY:
WORKSHOP FOR LANDOWNERS**

Caledon East – April 15, 2008

Considerations in Creating Endowed Gifts

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent

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OVERVIEW

- What Is an Endowment?
- What Are the Advantages of an Endowed Gift?
- What Are the Tax Implications of an Endowed Gift?
- What Are the *Income Tax Act* Requirements of an Endowed Gift?
- What Should Be Considered in Structuring a Donor Endowment Agreement?
- What Should Be Considered in Structuring a Board Endowment Fund?
- How Should an Endowed Gift Be Protected?

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WHAT IS AN ENDOWMENT?

- Generally, an endowment is a charitable trust for a restrictive purpose (i.e. a special purpose charitable trust)
- With regard to ecological gifts, an endowment can be of assistance in establishing a type of "Stewardship Fund" in order to help maintain an ecological gift of land over the years
- An endowment is a gift where the capital is held for at least 10 years but can extend beyond for any period of time up to in perpetuity

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- Normally, the term of endowment infers that the capital is held in perpetuity
- An endowment can be created by either the donor through an endowment agreement (donor endowment agreement) or by the board in initiating the creation of an endowment fund (board endowment fund)
- An endowment can be made up of capital in the form of cash, shares or any other type of property
- Under the *Income Tax Act*, an endowed gift is generally referred to as a “ten year gift” under the broader new category of “enduring property”

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- The income (e.g. the interest, dividends or realized capital gains) can either be expended in total each year or can be reinvested in whole or in part
- The capital and/or the income can be restricted to a particular use, such as scholarships, or can be left unrestricted and used for the general charitable purposes of the charity
- The disbursement of income and capital by the charity can be left to its discretion or can be subject to donor advice, e.g. a donor advised fund discussed further below

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- WHAT ARE THE ADVANTAGES OF AN ENDOWED GIFT?**
- It permits the creation of a capital fund on a long term or perpetual basis in order to support either specific projects or the general operation of a charity, such as a “Stewardship Fund”
 - It creates long term stability by balancing against possible fluctuations in yearly fundraising
 - It allows donors to create a fund in the name of the donor or their families in order to have a long term impact on charitable programs

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- It facilitates the donor acquiring naming rights for a particular project or have naming rights placed on a building for a specific period of time
- It permits the creation of both large segregated endowed funds that are initiated by the donor, as well as smaller contributions to existing board endowed funds that are established by the charity
- If an endowment fund is operated through a parallel foundation of a charity, then the endowment fund can be protected from creditors of the operating charity

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- WHAT ARE THE TAX IMPLICATIONS OF AN ENDOWED GIFT?**
- Enduring Property**
- An endowed gift, e.g. a gift where the capital is held for at least 10 years or is a bequest or inheritance (now both part of “enduring property”) has tax implications under recent May 2005 amendments to the *Income Tax Act*
- 80/20 D.Q.**
- An endowed gift is excluded from the 80/20 disbursement quota of the recipient charity, provided that the endowed gift is held for at least ten years

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- A transfer of an endowed gift (e.g. enduring property) between a recipient charity (such as to a parallel foundation) and another charity does not affect the 80/20 disbursement quota of either
- 3.5% D.Q.**
- An endowed gift, though, will generally be subject to the 3.5% disbursement quota
 - The 3.5% disbursement quota only applies to those registered charities that hold investment assets greater than \$25,000

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Encroachment on Enduring Property

- **If interest and dividend income is not sufficient to meet the 3.5% disbursement quota, then the charity can encroach on realized capital gains up to the lesser of the capital gains pool and 3.5% of the investment assets of the charity, provided that the terms of the gift agreement permit such an encroachment during the first ten years of the endowment**

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WHAT ARE THE *INCOME TAX ACT* REQUIREMENTS OF AN ENDOWED GIFT?

- **An endowment must meet the statutory requirements under the *Income Tax Act* for a ten year gift**
- **A ten year gift must be subject to a trust or a direction and be held for a period of not less than 10 years**
- **The documentation required to evidence a ten year gift must include the following:**
 - **The document must be executed by the donor for each gift that is made**
 - **The document must clearly identify the donee charity, including its official name and registration number**

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- **The document must indicate the amount of the gift**
- **The document must set out the date the gift is made**
- **The document must set out the name and address of the donor**
- **The document must set out the serial number of the official receipt issued to the donor for the gift**
- **The information must be attached to charity's duplicate copy of receipt**

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WHAT SHOULD BE CONSIDERED IN STRUCTURING A DONOR ENDOWMENT AGREEMENT?

- Is there a minimum amount required to establish a donor endowment agreement?
- Is the fund created by a donor endowment agreement to consist of monies or gifts in kind, e.g. shares?
 - e.g. If it is a gift of shares, then 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

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- Is the capital of the fund to be held in perpetuity or for a period of at least 10 years?
- During the first ten years, is the charity to have the ability to encroach on realized capital gains?
- If the fund is to be held for at least 10 years, but not in perpetuity:
 - When can the capital be expended after 10 years?
 - What is the capital to be used for at that time, e.g. are there any restrictions which apply?

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- For a fund that is to be held in perpetuity, can the charity encroach on the capital after 10 years and if so, under what circumstances?
 - e.g. Meeting the yearly disbursement quota shortfall
 - e.g. In the event of extenuating circumstances encountered by the charity in the discretion of the board

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• **Are further contributions of capital permitted and, if so, are there any limitations?**

- From whom can the contributions be received?
- Are the imposition of further limitations to be permitted?
- Are there time or quantum limitations on further contributions?

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• **What is the purpose of the fund, e.g. is there to be a restriction in relation to the use of the income and/or capital or can the income and/or capital be used for the general charitable purpose of the charity?**

• **Is the application of the income/capital to be structured as a “donor advised fund” and if so, is it clear that the board of the charity must ultimately exercise its discretion over the expenditure of the income and/or capital as opposed to that of the donor?**

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• **Is the investment policy of the charity to be incorporated by reference into the endowment agreement or is the donor allowed to impose specific investment terms of reference on the gift?**

- Does the prudent investor standard from the *Trustees Act* apply?
- Does the charity have an investment policy?
- Does the charity have an agency agreement to delegate investment decision making to an investment manager?
- Is the donor able to impose restrictions on the type of investment and what happens if the restrictions no longer are prudent in the circumstances?

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- Is the charity able to charge a reasonable administrative charge against the income of the endowment fund?
- Are the details of an administrative charge contained in the endowment agreement or is it to be cross-referenced to the gift policy of the charity
- Does the charity have a disbursement policy to determine how much income is to be paid out each year from the endowed fund and how much is to be reinvested and under what circumstances there can be an encroachment on capitalized income and capital?

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- Does the endowment agreement permit a transfer of the endowed fund and change of trustee to another charity, such as a parallel foundation?
- Does the endowment agreement include a *cy prés* type of clause to permit the charity to change the purpose of the gift in the event that the original purpose becomes impossible or impractical?
- Does the endowment agreement need to include a determinable gift provision to protect the endowed gift by requiring it to be transferred to another charity in the event of the insolvency, bankruptcy or winding up of the charity?

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- Does the endowment agreement permit amendments to the administrative terms of the agreement?
- Is the donor to be given naming rights? If so:
 - How long do the naming rights extend for?
 - Has the charity retained the right to terminate the naming rights of a donor and under what circumstance?

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WHAT SHOULD BE CONSIDERED IN STRUCTURING A BOARD ENDOWMENT FUND?

- The board of the charity should create the terms of a board endowment fund by adopting a board resolution
- There should be a board resolution to authorize each board endowment fund
- The substantive terms of a board endowment should generally be similar to the terms of a donor endowment agreement as described above

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- Example of board endowed funds could include for example
 - A perpetual endowment fund
 - A building fund
 - A debt reduction fund
 - A scholarship fund
 - A named conservation fund, such as a “Stewardship Fund”

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- Have the terms of the board endowment fund been adequately communicated to the donor in writing or is it available at the website of the charity?
- Is there some form of an endowment fund contribution agreement in order that the donor can evidence in writing that the gift meets the requirements of a ten year gift under the *Income Tax Act*?

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HOW SHOULD AN ENDOWED GIFT BE PROTECTED?

- **Impact of the *Christian Brothers Ont.* Court of Appeal decision**
 - **Endowed gifts will now be at risk to creditors of the charity**
 - **Claims against operating charities that hold large endowed funds may increase**
 - **The ability of donors to create enforceable restricted gifts may be in question if not properly structured**
 - **Donors may become more reluctant to give large gifts directly to an operating charity**

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- **Developing a strategy in reserve**
 - **Establish and/or utilize an arms-length parallel foundation to receive endowed gifts**
 - **Possibly utilize a community foundation or trust company to receive endowed gifts**
 - **Structure a gift as a determinable gift with a gift over to another charity in the event of an actual or pending insolvency or bankruptcy of the charity**

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