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Donor Rights and Remedies

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INTRODUCTION

- Donors are becoming more sophisticated and want to ensure that their gifts are being used in the manner the donor wants
- Charities and their directors can face exposure to liability from donors in many situations
- It is important for charities to understand what donors' rights are and what remedies are available to them
- Charities need to implement policies and procedures to avoid liabilities and to ensure donors' rights are respected
- This presentation provides a general overview of how these issues apply to fundraisers and senior managers associated with charities

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OVERVIEW

- A. Inherent Rights of Donors
- B. Statutory Rights of Donors
- C. General Areas of Liability Exposure and Donor Remedies
- D. Donor-restricted Charitable Gifts
- E. Risk Management Strategy

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A. INHERENT RIGHTS OF DONORS

- Donors have inherent rights, which generally include the right to
 - Disclosure of information
 - No undue influence
 - Act in the interest of the donor
 - Independent legal advice
 - Compliance with gift restrictions
 - Confidentiality

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1. Right to Disclosure of Information

- Based upon recent case law, a donor is entitled to reasonable disclosure of relevant information – for example
 - Fundraising
 - Purpose of the fundraising - for the general charitable purpose of the charity or restricted charitable purpose
 - General costs – excessive?
 - Conducted through a paid fundraiser or volunteers
 - Disclosure of fundraising costs

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- Relevant financial information
 - To help the donor make an informed decision concerning a donation and the charitable program that it will be used in conjunction with
 - e.g., providing a copy of the most recent financial statements of the charity, and an explanation of the cost of the project that the fundraising is being undertaken to fund
- A donor should be entitled to expect that the charity be transparent when providing the relevant information
- A donor should be entitled to expect that the information provided is accurate
- But the donor's right to disclosure should be limited to obtaining reasonable and relevant information

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2. Right Not to be Subject to Undue Influence

- A donor should be entitled not to be subject to any direct or indirect undue influence by the charity's fundraising
- For example:
 - Repetitive and persistent requests for funds
 - A fundraiser or a charity's representative intentionally develops a close relationship with a donor for the primary purpose of cultivating trust and dependency between the donor and the fundraiser in order to solicit a gift

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3. Right to Act in the Interest of the Donor

- In certain situations, a donor may be relying on a charity for advice, e.g., tax advice, prudence of a gift
- In this type of a situation, there may be an implied obligation on the charity to protect an overly eager donor from making a charitable gift if to do so would not be in the best interests of the donor, e.g.,
 - Leaving all assets to a charity and not provide for the donor's dependents
 - Donating his/her home to a charity but not securing alternate accommodation
- *Aids Society for Children (Ontario)* case held that the relationship between donors and charities involved in fundraising is that of a fiduciary relationship

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4. Right to Independent Legal Advice

- Every donor has the right to obtain independent legal advice before making a gift
- In some situations, the donor should be actively encouraged to do so – for example
 - Specific income tax consequences unique to the donor's circumstances
 - A vulnerable donor wishing to make a donation that involves an investment that could negatively impact the donor's financial resources or the donor's ability to meet obligations to dependents (during lifetime or after death)

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5. Right to Compliance with Gift Restrictions

- Sometimes, a donor may impose restrictions on a gift, e.g., how the gift is to be used or how long the gift is to be held (such as endowments)
- Sometimes, a gift by a donor may be subject to implied restrictions, e.g., representations made in fundraising materials such as brochures or website
- In both cases, a donor has the right to expect that the terms of the restrictions will be complied with by the charity and its board of directors

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6. Right to Confidentiality

- Every donor is entitled to confidentiality concerning their identity, and the nature of the gift that they have given, unless the donor consents to the disclosure of the information
- This should be reflected in the charity's privacy policy and gift acceptance policy
- This would involve assurance that a donor's list is not sold, rented or exchanged, unless an exception is provided for in a privacy policy, such as between closely related charities (e.g., a hospital and its parallel foundation)

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B. STATUTORY RIGHTS OF DONORS

- *Income Tax Act*
- Provincial fundraising and charities legislation
- Corporate legislation – if a donor is also a member or director of a charity
- Not an exhaustive overview

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1. *Income Tax Act*

- No specific statutory rights for donors under the *Income Tax Act*
- Not legally entitled to donation receipts – but if a donation receipt is issued, then the donor is entitled to expect that the receipt is accurate
- An effective indirect remedy is that a donor may make a complaint to CRA if the donor has concerns about whether a charity's fundraising practices or operations comply with the numerous requirements under the *Income Tax Act*
- Result of a CRA complaint - CRA may audit the operations of the charity and this may result in sanctions against the charity

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2. Provincial Fundraising and Charities Legislation

- Some provinces have legislation in relation to fundraising and charitable matters to provide certain rights to donors
- The following is a brief overview

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Charities Accounting Act (Ontario)

- Oversight by the Ontario Public Guardian and Trustee (OPGT)
- Section 6 – any person (e.g., a donor) may complain against a charity's fundraising practices or management of a gift with a judge of the Superior Court of Justice, who may then order an investigation by the OPGT
- Section 10 - two or more people (e.g., donors) may allege a breach of trust involving a charitable purpose and may apply to the Superior Court of Justice for an order or direction as the Court considers just, including an order for an investigation by the OPGT

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- Subsection 4(d)
 - Allows the court to grant various orders if a charity “is not applying any property, fund or money in the manner directed by” the donor
 - Not a specific right of a donor, but it could be used as a mechanism to enforce directions imposed by the donor when a gift was made
 - A complaint by a donor may result in the OPGT seeking an order that would indirectly cause a review of the fundraising practices of the charity

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- Section 3
 - Gives OPGT the right to require a charity to submit its accounts for a formal passing of accounts before a judge
 - Not a specific right of a donor – but a donor may make a complaint to the OPGT concerning a fundraising practice of a charity or a misapplication of directed funds, then the OPGT may require the charity concerned to conduct a formal passing of accounts

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Charitable Fund-raising Act (Alberta)

- If a charitable organization raises \$25,000 or more in a year as a result of solicitations from individuals and/or others in Alberta, it must register within 45 days of the gross contributions reaching \$25,000
- Scope of the statute is broad - not limited to charities registered with CRA
- Requirements of charities include
 - Registration and maintenance of records [s. 7, 14]
 - Provision of information to donors [s. 6, 9]
 - Complying with fundraising rules [Part 2]
 - Complying with standards of practice [s. 31, 32]

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- Remedies for donors
 - Unregistered charitable organizations that request contributions for their own use or for charitable purposes are liable to a fine [s. 55(2)]
 - Compensation to an aggrieved person for loss associated with the offence committed [s. 56]
 - Directors and officers of the charity may be held personally liable for an offence committed by a corporation [s. 55(3)]

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Charitable Fund-raising Businesses Act (Saskatchewan)

- Regulates for-profit, fundraising businesses that raise funds on behalf of charitable organizations
- Provides potential donors with the right to certain information relating to the charitable purpose and the fundraising activities of the charity
- Unless specifically requested by the potential donors, those who have been solicited by telephone communication are entitled to limited information

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- Potential donors have the right to request that the charitable organization, which contacted them, refrain from making solicitations to them in the future. The organization is then obligated to place their name on an internal list of individuals who have made that request
- Remedy – the Registrar may conduct investigations and cancel licenses if a fundraising business has committed an offence under the statute

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Charities Act (PEI)

- Any person, association, institute or organization, under whose auspices funds for benevolent, educational, cultural, charitable or religious purposes, that directly or indirectly solicits or makes any appeal to the public for donations in PEI must register pursuant to the *Charities Act* (Prince Edward Island) [par. 3(1)(a)]
- Soliciting funds in the province without registering under the Act is an offence and upon summary conviction, a fine not exceeding \$500 may be imposed [s. 10(1)]
- The Act does not apply to an organization or foundation that is a registered charity for the purposes of the *Income Tax Act* [s. 2]

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The Charities Endorsement Act (Manitoba)

- Unless authorization has been obtained by way of application to the Manitoba Consumers' Bureau, persons, associations, societies, or other organizations or body of persons are prohibited from engaging in any means of direct or indirect solicitation (e.g., telephone, mail, home-to-home canvassing, etc.) of money, goods or financial assistance, as well as on the sale, provision or offering to sell or provide any goods, services or anything of value on the basis that the donations or proceeds will go to a charitable purpose

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- Solicitation of donations from current members is exempt from the provisions of the Act [para. 2(2)(a)], but "member" does not include a person who becomes a member in order to make a donation [s. 2(3)]
- Remedy - a fine of a maximum of \$50 and/or imprisonment of up to 10 days if an individual and a fine of \$500 if a corporation [s. 4]

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Charitable Purposes Preservation Act (B.C.)

- To prevent donations given for a specific charitable purpose from being used for objects other than those intended by the donor
- Protects gifts that qualify as "discrete purpose charitable property", i.e., gifts that are
 - Given to a charity for a specified charitable purpose
 - Identified with certainty by the donor, either expressly or through some formula or method
 - Donated with the express or implied intention that it will be kept and administered by the charity separately from any other property, and used exclusively to advance the specified charitable purpose [s. 2(1)]

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- Obligations of charity
 - Charities must follow the intentions of the donor in order for the property to retain its character as discrete purpose charitable property [s. 3(1)]
 - Charities must keep the discrete purpose charitable property separate and apart from other property [s. 2(1)(c)(i)]
- The charity will have no beneficial interest in the property and it will be protected from any seizure or attachment to satisfy a debt or liability of the charity, except those debts or liabilities incurred by the charity in "advancing, or in attempting or purporting to advance, the discrete purposes of the property" [s. 2(4)]
- Remedies for donors - Broad authority given to the courts to make whatever order it considers necessary

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3. Corporate Legislation

- If a donor is also a member or director of the charity, the donor may have rights in their capacity as a corporate member or director in order to pursue the person's interests as a donor
- What remedies that are available will depend on the legislation, the incorporation document, by-laws and other governance practice and policies
- Possible remedies may include
 - To obtain information
 - To call a members' meeting to remove the directors and elect a new board
 - To seek relief from court

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- Federal *Canada Corporations Act* – few entitlements
- Federal new *Canada Not-for-Profit Corporations Act*
 - Provides expanded rights to members/directors to obtain information
 - Provides expanded member remedy rights
- Provincial corporate legislation

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C. GENERAL AREAS OF LIABILITY EXPOSURE AND DONOR REMEDIES

- Charities can face exposure to liability from donors in many situations
- What may go wrong?
 - Charity does not comply with the rules
 - Donor does not understand the legal parameters that the charity has to comply with
 - Donor does not understand what they are entitled to
 - Miscommunication between charity and donor
 - Donor's expectation is different from what the donor gets from the charity

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- Common remedies available to donors
 - Complaint in the media
 - Complain to CRA – which may lead to a CRA audit of the charity
 - Complain to provincial regulators, such as OPGT in Ontario
 - Corporate remedies if the donor is also a member or director of the charity

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- Court action
 - Examples of possible basis of the claim include breach of trust, breach of fiduciary duties, misrepresentation, undue influence
 - Examples of relief that may be sought
 - To enforce compliance with gift restrictions
 - To invalidate the gift, e.g., negligent misrepresentation, undue influence
 - To pass account
 - For the return of the gift (?) – may not be possible
 - May even seek recourse against the directors on a personal basis

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- Four common situations where a charity and its board of directors may face liability exposure from aggrieved donors
 - Misrepresentation involving the issuance of donation receipts
 - Failure to comply with donor restrictions
 - Detrimental reliance upon charitable endorsements
 - Failure to disclose excessive fundraising costs
- Only examples, not exhaustive

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1. Misrepresentation Involving the Issuance of Donation Receipts
 - A charity does not have a legal obligation to provide a donation receipt for a gift
 - However, where a charity does provide a donor with a donation receipt, then the receipt must be in prescribed form, contain accurate information and the donor would expect that the receipt would not be challenged by CRA
 - Issuing incorrect or false receipts will expose the charity to sanctions by CRA
 - The issuance of an incorrect receipt can result in a 5% penalty on the amount of the receipt
 - The issuance of a false receipt can result in a 125% penalty on the amount of the receipt and possibly the suspension of receipting privileges

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- Misrepresentation involving a receipt may occur where
 - No donation receipt is issued by the charity where the donor was expecting a receipt, e.g. where the charity treats the contribution as a sponsorship but the business assumed it was a receiptable gift
 - The amount shown in the receipt is different from the amount that the donor had expected, for example because
 - Different appraisal value
 - Deduction of the amount of the advantage of the gift
 - Deeming of FMV due to the anti-tax shelter provisions on deemed FMV
 - The donation receipt is challenged by CRA, e.g. with regards to donation tax shelter schemes

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- Remedies for donors
 - Court action
 - A claim for negligent misrepresentation by the charity, its directors or staff, concerning the availability and/or the amount of the donation receipt or other tax benefits that the donor had expected to receive
 - The donor may attempt to hold the charity, and arguably even the directors, liable for the loss or reduction in the tax credits or tax deduction available to the donor
 - Complain to CRA – may lead to CRA audit
 - Complain to OPGT
 - Complaint in the media

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2. Failure to Comply with Donor Restrictions

- Donors often include restrictions on the donations they make in terms of how and when the charity may use the donation
- Liability may result if the charity uses the gift in a manner that is contrary to the specific terms of the stipulated restrictions
- Liability may also result if the charity applies a gift in a manner that is not within the donor's reasonable expectations of what the gift should be used for where there is room for interpretation
- Restricted gifts are discussed later

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- Remedies for donors
 - Court action
 - A claim of breach of trust of the terms of the special purpose charitable trust
 - A claim for negligent misrepresentation of what the charity had purportedly promised to do with the gift once received
 - Complain to CRA – may lead to CRA audit
 - Complain to OPGT
 - Complaint in the media

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3. Detrimental Reliance Upon Charitable Endorsements

- Charities may directly or indirectly endorse the products and/or services of a business sponsor
- Liability may occur if the product or service turns out to be defective and the donor claims that he/she only purchased the product or service in the first place because the charity endorsed it - e.g.
 - Camping equipment endorsed by an environmental charity
 - Food products endorsed by a promotion of health charity

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- Remedies for donors
 - Court action
 - A claim for damages
 - Based on detrimental reliance and failure of the charity and its directors to adequately warn them
 - Complain to CRA – may lead to CRA audit
 - Complain to OPGT
 - Complaint in the media

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- 4. Failure to Disclose Excessive Fundraising Costs
 - At common law, a charity and its board of directors have a fiduciary obligation to disclose to a donor the fundraising expenses that may be excessive when seeking a donation
 - *Ontario (Public Guardian and Trustee) v. The Aids Society for Children (Ontario)*, [2001] O.J. No. 2170
 - *Ontario Public Guardian and Trustee v. National Society for Abused Women and Children*, [2002] O.J. No. 607 (Sup. Ct. Jus.)

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- CRA Fundraising Guidance requires charities to disclose their fundraising costs, revenues and practice
 - Generally greater disclosure required for solicitation to the public than to members
 - The higher the cost for a fundraising activity, the more there is a need for disclosure
 - Information must be accessible (e.g. the web and annual reports) and accurate, (e.g. the best information available)
 - A charity may need to consider disclosing information before, during and after a fundraising initiative
 - Fundraising ratio

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- Remedies for donors
 - Complain to CRA – may lead to CRA audit
 - Court action
 - Based on misrepresentation and breach of public policy
 - To declare the gift void and to be returned
 - Complain to OPGT
 - Complaint in the media

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D. DONOR-RESTRICTED CHARITABLE GIFTS

- Non-compliance with gift restrictions is one of the most common areas where liability may arise
- An unrestricted charitable gift is a gift to be applied towards the general charitable purposes of a charity that is not subject to any restriction by a donor
- Examples of unrestricted charitable gifts
 - Government grants not restricted to a specific program
 - Gifts that are directed to be used for the general purposes of a charity
 - Board designated funds that are internally restricted

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- A restricted charitable gift is a gift that is subject to restrictions imposed by the donor that constrain how a charity can use the gift
- Important for a charity to understand the nature of the restriction that has been imposed and the importance of complying with the restrictions
- Examples of donor-restricted charitable gifts - endowment funds, restricted use funds, restricted charitable trust property of real estate (subject to certain terms of trust contained in the deed of the property)
- Restricted gift can be created expressly (such as a gift agreement) or impliedly (such as a letter or a memorandum of discussions with a donor to determine his or her intent, or representations in fundraising materials)

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- Precatory trust is a non-binding request of the donor
 - Donor gives "suggested direction" which is an expressed preference, desire or request, not legally enforceable
 - Moral obligation on the charity to comply
- Donor advised fund allows the donor to make non-binding recommendations periodically as to the distribution of assets from the fund
 - According to CRA, a donor can require a gift to be used in a particular program provided that the decision regarding use of the donation within the program rests with the charity
 - If donor retains too much control over the gift it will no longer be considered a gift at law, in which case it cannot be receipted

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- Consequences for non-compliance with donor restrictions
 - Personal liability for breach of trust involving a restricted gift
 - Directors may be found jointly and severally liable
 - Directors may be liable to compensate the charity for the full amount of any loss suffered as a result of the failure to comply with the restricted gift

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- Potential personal liability of the board of directors for
 - Breach of trust
 - Losses resulting from an *ultra vires* or unauthorized charitable purpose
 - Third party claims by donors and residual beneficiaries
 - Losses resulting from accrued interest that would have been applied to the misdirected funds
 - Statutory remedies, as summarized above
 - *Criminal Code* charges, if a failure to comply with donor restrictions was done with an intent to defraud [s. 336]

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- Breach of trust – examples
 - Diverting funds intended for one charitable program for use in another charitable program
 - Withholding a fund and not applying it to the charitable purpose intended by donor
 - Concealing the existence of a restricted charitable trust fund
 - Placing funds into a perpetual endowment fund when the fund is meant to be for short term use
 - Encroaching upon the capital of endowment fund intended to be held in perpetuity
 - Using surplus funds for a different charitable purpose without court authorization
 - Altering donor restriction without court approval unless pre-authorized by donor

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- A donor-restricted charitable gift may only be varied by the courts through an application to court for a *cy-près* order
- Where court approval may not be necessary
 - A *cy-près* application is unsuccessful and there is no gift over to another charity and the gift reverts back to the donor
 - The gift fails because of either a condition precedent or a condition subsequent where there is a reversion back to the donor

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E. RISK MANAGEMENT STRATEGY

- When communicating with a donor interested in making a gift
 - Only accept gift restrictions that can be achieved by the charity
 - Try to make the specific purpose of a gift as general as possible, or build in a back-up purpose, especially if it is a long term gift
 - Include power of the charity to amend the purpose of the gift if it becomes impossible or impractical
 - Confirm everything in writing and document the file

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- Ensure information provided to the donor is accurate and transparent
- Do not provide legal or tax advice to the donor, and ensure that the donor understands that
- Encourage the donor to obtain independent professional advice – legal, financial and tax
- Consider what would be in the best interest of the donor
- Ensure donor information is kept confidential unless prior consent is obtained from the donor for disclosure
- Charitable endorsement
 - Due diligence on the partner and their product being endorsed

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- Fundraising
 - Adopt a fundraising policy to ensure due diligence and good practice
 - Ensure compliance with CRA's Fundraising Guidance
- Gift acceptance
 - Adopt a gift acceptable policy
 - Ensure due diligence and good practice
- Gift management of gifts
 - Ensure compliance with gift restrictions
 - Clear documentation of what restrictions apply to what gifts, tracking mechanism
 - Policies and procedures to ensure compliance with gift restrictions

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- General representation and operation of the charity
 - Ensure all publications of the charity provide accurate information
 - Including website, promotion brochures, annual reports, notes in financial statements, T3010 reporting
 - Ensure consistency of information in various publications
 - Policies and procedures to provide checks and balances

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- Donor relations
 - On-going communications with donors to keep them informed how their gifts are being used
 - Donor education to ensure donors understand the rules that the charity has to comply with
- Staff and directors education
 - Fundraising staff, publication staff, communications staff, board of directors
 - Updates on legal development and good practices

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