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# CANADIAN ASSOCIATION OF GIFT PLANNERS (CAGP)

Quebec – April 18, 2013

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## Drafting Issues for Donor Restricted Gifts

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 BARRISTERS SOLICITORS TRADEMARK AGENTS	<b>Canadian Association of Gift Planners (CAGP) Workshop Session</b> <b>Gatineau, Quebec – April 17-19, 2013</b>
<b>DRAFTING ISSUES FOR DONOR RESTRICTED GIFTS</b>	
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<b>INTRODUCTION</b>
<ul style="list-style-type: none"><li>• This presentation highlights issues that gift planners will need to consider when drafting testamentary or <i>inter vivos</i> donor restricted gifts</li><li>• Donor restricted gifts should be tailored to the factual context and needs of the particular donor or the charitable client</li><li>• The key element of both testamentary and <i>inter vivos</i> donor restricted gifts is the establishment of a restriction<ul style="list-style-type: none"><li>– The restriction can relate to either how the gift is used or the time when it is applied</li></ul></li><li>• A charity that accepts a gift subject to a restriction is legally bound by that restriction</li></ul>
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<ul style="list-style-type: none"><li>• Irrespective of whether the charity understands the implications, a donor restricted gift normally consists of a restricted charitable purpose trust</li><li>• With restricted charitable purpose trusts, the charity becomes the trustee subject to the legal regime governing charitable purpose trusts</li><li>• Common types of restricted charitable purpose trusts include:<ul style="list-style-type: none"><li>– Endowments</li><li>– Long term funds</li><li>– Scholarship funds</li><li>– Building funds</li><li>– Donor advised funds, which are often placed with community foundations</li></ul></li></ul>
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- As donors become more sophisticated with their giving and demand greater accountability from charities, donor restricted gifts are becoming more common, particularly for large gifts
- However, failing to honour a donor restriction could:
  - Expose the charity, and its directors, to liability for breach of trust, and
  - Erode donor confidence and undermining the charity's credibility
- For more information, see *Considerations When Drafting Restricted Charitable Purpose Trusts* (2010) <http://www.carters.ca/pub/article/charity/2010/tsc1001.pdf> and *Donor-Restricted Charitable Gifts: A Practical Overview Revisited II* (2006) <http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>

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**TOPICS FOR DISCUSSION**

- Basic Attributes of a Charitable Purpose Trust
- Differences Between an Unrestricted and a Restricted Charitable Gift
- Different Types of Restricted Charitable Gifts
- Can the Terms of a Restricted Charitable Purpose Trust be Varied?
- What Provisions Should be Considered When Drafting a Restricted Charitable Purpose Trust?
- Basic Management Considerations for Donor Restricted Charitable Gifts

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**A. BASIC ATTRIBUTES OF A CHARITABLE PURPOSE TRUST**

**1. Definition of a Charitable Purpose Trust**

- A charitable purpose trust is a type of restricted charitable gift, as explained later in this presentation
- A charitable purpose trust has 3 characteristics:
  - Exclusive dedication of property,
  - To a charitable purpose,
  - That provides a public benefit

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**2. Reviewing the Basics of Applicable Trust Law**

- In order to properly draft a donor restricted gift consisting of a restricted charitable purpose trust, there is a need to understand the basics of trust law
- Trusts are usually established by trust documents with:
  - Certainty of intention
  - Certainty of subject matter
  - Certainty of objects
- A charitable trust document will set out:
  - The purpose or the objects of the trust
  - The property to be held in trust
  - The criteria for determining the beneficiaries or purpose
  - Instructions to manage the trust property

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- Trustees owe a fiduciary duty to beneficiaries
- Trustees must hold trust property for the benefit of the trust objects according to the terms of the trust
- When the objects of a trust are purposes rather than persons, there is no interested party who can compel proper administration of the trust
- Thus, the general law prohibits trusts for purposes
- However, charitable purpose trusts are an exception because the Crown, as *parens patriae* for charities, can enforce the performance of the trust
- In Canada, the Crown's prerogative is exercised by the Attorney General or the Office of the Public Guardian and Trustee (Ontario) ("OPGT") in Ontario

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- Trustees of a charitable purpose trust are also subject to general trust law principles involving administration
- For example, trustees must:
  - Keep the trust property segregated from other property, unless the trust stipulates otherwise
  - Act honestly and with due care and attention
  - Carry out the duties personally, delegating responsibilities only under limited circumstances
  - Place the interests of the beneficiaries or the purpose of the charitable trust first and ahead of the trustees' own interests
  - Be ready to provide full explanations of all of their dealings

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- Compared to other forms of trusts, charitable purpose trusts have certain beneficial attributes
- A charitable purpose trust:
  - Is an exception to the rule that purpose trusts are void
  - Does not require a beneficiary
  - Will not fail for uncertainty of objects, even though there are no identifiable beneficiaries - Trustees for charitable trusts may be given discretion to determine which individuals are beneficiaries
  - Can be rewritten by the court under certain circumstances to achieve the donor's intent

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- Is not subject to the "modern" rule against perpetuities
- Is exempt from the prohibition against indestructible or perpetual trusts
- Is exempt, in Ontario at least, from the rule of law and statutory enactments relating to accumulations
- Benefits from advantages accorded to charities that derive from taxing statutes

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**3. Limitations of Charitable Purpose Trusts**

- Charitable purpose trust must be devoted exclusively to charitable purposes
- Trusts for political purposes (even if otherwise for charitable purposes) are invalid
- The trust structure may expose trustees to liability more than other legal structures because the standard of care is higher

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13

**B. DIFFERENCES BETWEEN AN UNRESTRICTED AND A RESTRICTED CHARITABLE GIFT**

- When drafting testamentary or *inter vivos* restricted charitable purpose gifts, it is essential to understand the context of unrestricted charitable gifts as compared to restricted charitable gifts
- This difference is essential because significant legal consequences flow from whether a charitable gift is restricted or unrestricted

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**1. Unrestricted Charitable Gifts**

- An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose of a charity, whether the charitable purpose is in the form of a
  - charitable purpose trust,
  - charitable corporation, or
  - charitable unincorporated associationthat is not subject to any restrictions imposed either directly or indirectly by the donor
- The board of a charity may therefore apply an unrestricted gift to its charitable purposes in whatever manner it deems appropriate

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- This means that, provided that the board of a charity does not exceed its charitable purposes, the charity may use the gift as it wishes in its absolute discretion
- This may involve:
  - Disbursing all or a portion of the gift, or
  - Investing the gift over the short term and using the income to pursue any one of the authorized charitable purposes within the constating documents of the charity
- A board that designates an unrestricted charitable gift for a specific charitable purpose may subsequently apply the funds to a different charitable purpose within its charitable objects

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- Examples of unrestricted charitable gifts include:
  - General donor solicitation appeals, such as “Please support your local YMCA”
  - Gifts from donors, either while the donor is alive or through a testamentary instrument that does not include donor restrictions
  - Gifts that have been designated by the board for a particular purpose or held as a board initiated time restricted fund (internally restricted)
- The board may change or terminate the restrictions or purposes for which those funds have been applied in any manner that the board thinks is best to achieve the charitable purposes of the charity without the board being in breach of trust

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## 2. Restricted Charitable Gifts

- A restricted charitable gift generally means a gift at law to a charitable purpose that is subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors
- These limitations are imposed by the donor and constrain how the charity may use the gift
- While an unrestricted charitable gift is beneficially owned by the charity, restricted charitable gifts when structured as a restricted charitable purpose trusts are held by the charity in trust and are not actually owned beneficially by the charity
- For trust law purposes, each restricted charitable purpose trust is a separate trust

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- However, for administrative purposes, as long as the trustee is already a registered charity, a restricted charitable purpose trust is not required to be registered by CRA as a separate registered charity, although it could be if there was a practical reason to do so
- The board of a charity that receives a restricted charitable gift needs to identify:
  - The nature of the donor restriction
  - The legal implications of the restriction
  - The importance of complying with the restriction

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**C. DIFFERENT TYPES OF RESTRICTED CHARITABLE GIFTS**

1. Restricted charitable purpose trusts
  - a) Long-term gifts, including endowments
  - b) Restricted-use gifts
  - c) Restricted charitable trust property
  - d) Implied special purpose charitable trust funds
2. Precatory trusts and donor-advised funds
3. Conditional gifts
4. Determinable gifts
5. Gifts subject to donor directions under the *Charities Accounting Act*
6. Discrete purpose charitable property under the *BC Charitable Purposes Preservation Act*

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**1. Restricted Charitable Purpose Trusts**

- It is a gift held by a charity in trust for a specific charitable purpose that falls within the parameters of the general charitable purpose of the charity as set out in its constating documents
- A charity cannot hold property as a restricted charitable purpose trust where such purpose is outside the scope of the charity's corporate objects or purpose
- A charity can only use the gift to accomplish the specific charitable purpose established by the donor
- The Supreme Court of Canada has confirmed that "[t]he residue of the estate of the testatrix is given on a valid charitable trust. It is clear that it can never be used for any purpose other than the charitable one to which it is devoted"

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- Restricted charitable purpose trusts are also commonly referred to as:
  - Donor-restricted trust funds
  - Charitable trust property
  - Charitable purpose trusts
  - Special purpose charitable trusts
  - Restricted funds
  - Special purpose funds
  - Endowment funds

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- A restricted charitable purpose trust is established when the donor has expressed an intention that the property be held for a specific charitable purpose
- However, there are conflicting approaches concerning the type of evidence necessary to establish that the donor intended to create a special purpose charitable trust
- In *Christian Brothers of Ireland in Canada (Re)*, Blair J. held that a high, formal standard is required
- In *Rowland v. Vancouver College*, Levine J. determined that the requirements are less formal and can involve consideration of all relevant circumstances involved in making the gift
- The dichotomy between the two approaches remains unresolved

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- Until further judicial guidance is available, gift planners should include the formalities required to create a restricted charitable purpose trust in the document creating the donor restricted gift
- Specifically, gift planners should clearly categorize the gift as a restricted charitable purpose trust by naming the charity as the trustee, using the words "in trust", and explaining the specific charitable purpose for which the gifted property is to be used
- Failure to do so by gift planners who are instructed to establish a restricted gift might become the basis of criticism or even a claim in negligence for not ensuring that the intent of the donor had been adequately expressed to restrict the charity's use of the gift

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### a) Long-Term Gifts, Including Endowments

- These restrictions involve the length of time that a gift must be held, usually creating some type of long-term gift
- The income and normally the capital at some point are used either for a specific application, like a scholarship, or for the general charitable purposes of the charity
- Directed to be held in perpetuity as endowments, or for a fixed number of years
- The donor may give the charity a right to encroach on the capital during the hold period
- Once the hold period has expired, if applicable, the charity can distribute the entire capital of the gift

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- An endowment is the extreme form of long-term gift
  - The donor requires that the capital of the gift be held in perpetuity
  - Since charitable purpose trusts are exempt from the rule against indestructible or perpetual trusts, a charity may accept gifts where the capital is held in trust on a perpetual basis
- This method of funding is not available to non-profit organizations under subsection 149.1(l) of the *Income Tax Act* ("ITA"), since non-profit organizations do not constitute charitable purpose trusts at law

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- A charity usually invests the capital of a long-term gift, including an endowment fund:
  - According to the terms in the document that created the gift, or
  - According to the charity's investment powers, which are set out in its constating documents or its investment policy
- How the charity applies the investment income depends on:
  - Whether the gift agreement directs how the charity must use the income
  - Whether the board has established terms of reference concerning how it will apply income from a long-term gift

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- There are three ways in which long-term funds, including endowments, can be created:
  - By the board,
  - By the donor, or
  - By a combination of the two
- When the board of a charity creates a long-term fund, it usually advises potential donors of its initiative and then invites donors to contribute
- Long-term funds that are created by the donor are usually initiated through a testamentary gift or an *inter vivos* gift agreement

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**b) Restricted-Use Gifts**

- Restricted-use gifts oblige the charity to apply the capital and income according to the purpose stipulated
- Unless the gift also has a time restriction, the gift is to be applied immediately or in the near future
- Use restrictions often require the gift be applied to:
  - A particular capital use (e.g. a building program)
  - An operational use (e.g. a relief effort in a foreign country)
- In either situation, the use restrictions must be within the parameters of the charitable purpose set out in the charity's constating documents

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- Donors may also restrict how the charity carries out its charitable objects or purpose - For example:
  - Donors can restrict who may benefit from the gift
  - In such a situation, the board must ensure the restrictions are not repugnant or contrary to public policy, such as discriminatory against a disadvantaged group
  - Donors can restrict how the gift is used, either through an *inter vivos* or testamentary gift that includes a use or time restriction, or both
  - The board of a charity can also restrict the use of a gift by inviting donations for a specific purpose

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**c) Restricted Charitable Trust Property**

- Restricted charitable trust property is real estate that is gifted subject to terms of trust, usually contained in the deed to the property
- Religious charities often receive property through deeds that set out specific terms of trust
- These properties are usually created through a trust clause in a deed or transfer of land
- This can occur when:
  - A donor gifts property to a charity for a particular purpose
  - The charity itself imposes the terms of trust stating that the property acquired will only be used for a specific purpose or purposes

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- Generally, restrictions found in deeds containing restricted charitable purpose trusts tend to be of a religious nature and fall into one of three categories:
  - Restrictions pertaining to religious doctrine (i.e. requiring the property be used only for individuals who subscribe to a particular religious doctrine)
  - Restrictions pertaining to use (i.e. limiting the property to a particular use, such as use for a church, cemetery or seminary), or
  - Restrictions limiting the use of the property to those who follow a particular religious practice, such as requiring the property be used only by members of a church who adhere to the practice of "strict communion"

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**d) Implied Restricted Charitable Purpose Trust Funds**

- "Implied" means the donor intended to create a restricted charitable purpose trust, but did not do so explicitly
- Therefore, this is a distinct from an "express" restricted charitable purpose trust
- Evidence of intent could derive from the circumstances surrounding the gift or the language in the document
- Examples of implied restricted charitable purpose trust
  - A charity initiates a public fundraising campaign for a specific charitable purpose
  - A donor does not provide documentation setting out his intentions, but expresses a specific purpose in discussions with the charity prior to making the donation

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**2. Precatory Trusts and Donor-Advised Funds**

- Unlike other forms of restricted charitable gifts, precatory trusts and donor-advised funds do constitute legally enforceable restrictions
- The donor expresses a preference, desire or request that something specific be done with the gift
- However, such expressions are "suggested directions" rather than legal obligations upon the charity
- Nonetheless, these gifts do come with practical consequences and moral obligations for the charity

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- A precatory trust is actually not a trust at all, but a nonbinding request of the donor
- Thus, they are more accurately described as unrestricted gifts that are accompanied by a nonbinding designation (or "designated gifts")
- Distinguishing precatory wishes from binding trust obligations can be difficult
  - "In trust," "on condition that," or other mandatory language suggests a legally binding restriction
  - Words such as "wish" or "desire" suggest the donor did not intend to create a legal obligation
- The difficulty arises when donors use less than clear or contradictory terminology - in which event, professional advice is recommended

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- Unlike designated gifts or precatory trusts, the donor of a donor-advised fund may have ongoing input into how the funds are distributed
- The advantage of donor-advised funds is they provide a donor with a tax receipt while deferring the ultimate disbursement for future charitable projects but with ongoing input from the donor
- This can be concerning, though, in that if the donor retains too much control, the fund will no longer be considered a gift at law and therefore cannot be receipted under the ITA
- Thus, these funds can be challenging for the charity to correctly administer

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### 3. Conditional Gifts

- Conditional gifts are similar to restricted charitable purpose trusts
- However, a charity becomes the beneficial owner of a conditional gift, either after the condition has been fulfilled or until a condition subsequent fails or occurs
- Conversely, a charity never becomes the beneficial owner of a restricted charitable purpose trust and, instead, holds the gift in trust, subject to certain terms and restrictions

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- A conditional gift may also include a restricted charitable purpose trust if the gift involves both a condition precedent and a requirement that it be used for a particular purpose
  - e.g., "I give \$1,000,000.00 as a perpetual endowment for cancer research, on the condition that the charity opens a cancer research facility in Calgary by the year 2014"
- The operative wording of a conditional gift involves a transfer of beneficial ownership, subject to an independent clause of defeasance commencing with words such as "but if", "provided that", or "on condition that"

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- Conditional gifts are subject to either a condition precedent or a condition subsequent
- A condition precedent occurs when the condition must be fulfilled *before* the gift takes effect
  - e.g., a gift of \$100,000 provided that the registered charity is able to raise an equal amount of money within a stated period of time
  - A charity should only issue an official donation receipt after the condition has been met
- A condition subsequent is operates to defeat a gift which has already been made
  - e.g., a gift made to a charity on the condition that the funds continue to be used to operate a particular named shelter for the homeless

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**4. Determinable Gifts**

- A determinable gift consists of a limited interest which will eventually come to an end
  - e.g., "I give the income from my commercial building so long as I own the building and the charity uses the property income to run a youth centre"
- It may be limited to endure only during the continuance of a particular state of circumstances, or until the happening of an uncertain event
- In this regard, a determinable gift bears a seed of its own destruction and is said to determine automatically

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**5. Gifts Subject to Donor Directions Under the Charities Accounting Act**

- In Ontario, donors also have the ability to enforce their restrictions via statute
- 4(d) of the *Charities Accounting Act* ("CAA") allows the OPGT to seek a court order requiring a charity to comply with the directions of a donor
- To do so, the OPGT must establish that the donor gave a "direction", but not that the donor had actually created a restricted charitable purpose trust

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- Also, subsection 10(1) CAA allows donors to apply to the Superior Court of Justice for an order that the charity carry out the trust subject to terms that the court considers just
- Section 10 therefore encompasses two rights of action for aggrieved individuals:
  - They can allege breach of a trust created for a charitable purpose, *or*
  - They can seek the direction of the court for the administration of the charitable purpose trust
- In this regard, the CAA is a powerful tool for donors and family members of donors who feel aggrieved

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**6. Discrete Purpose Charitable Property Under the Charitable Purposes Preservation Act**

- The *Charitable Purposes Preservation Act* (the "CPP Act") was proclaimed in force by British Columbia's provincial government on March 8, 2007
- The CPP Act did not change the BC common law of trusts, but provides additional protection where donors make a gift for a specific charitable purpose
- A charity receives no beneficial interest in discrete purpose charitable property and the property cannot be seized to satisfy a debt of the charity (except debts incurred to advance the discrete purpose)
- Also, the charity must keep, use, and administer the property according to the donor's intention and exclusively for to advance the discrete purpose

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#### D. CAN THE TERMS OF A RESTRICTED CHARITABLE PURPOSE TRUST BE VARIED?

- Many donors and charities believe they can vary the terms of a restricted charitable purpose trust at will
- In fact, unless the trust document permits the charity to vary the restriction, a restricted charitable purpose trust can only be altered by the court
- In these circumstances, a party must apply to the court for a *cy-près* order or proceed on the basis of a consent order from the OPGT under section 13 of the CAA
- *Cy-près* allows the court to exercise its inherent jurisdiction to supply trust purposes (or objects) in place of those the donor or testator chose

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- To avoid
  - the complexities of a *cy-près* court application,
  - the costs of a *cy-près* court application, and
  - the possibility that the court may not find a general charitable intention in relation to a surplus for a public fundraising campaign,a charity should state on its fundraising literature or website that the charity will use any surpluses from its public fundraising campaigns for a particular project to further its general charitable purposes

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#### E. WHAT PROVISIONS SHOULD BE CONSIDERED WHEN DRAFTING A RESTRICTED CHARITABLE PURPOSE TRUST?

- As explained above, the most prevalent type of donor restricted gifts are restricted charitable purpose trusts
- Failure to comply with the terms of a restricted charitable purpose trust could result in the board of directors being found in breach of trust and exposed to personal liability
- Accordingly, gift-planners must ensure the validity of the trust and the legal and moral implications of the trust when drafting testamentary and *inter vivos* restricted charitable purpose trusts
- The following principles also apply in general terms to other types of donor restricted gifts

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### 1. Initial Considerations Involving Endowment Funds

- Gift-planners should use the term “endowment” carefully when drafting restricted charitable purpose trusts
- “Endowment” is not a *legal* word, but a term of art that is often used to express the intention that the capital of a restricted purpose charitable trust fund be held “in perpetuity”
- However, the word “endowment” has also been used in recent years to refer to trusts where the capital was to be retained for a minimum of 10 years for disbursement quota purposes under the ITA
- As a result, the words used in a restricted charitable purpose trust must carefully reflect what the donor wants and what the charity will accept

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### 2. Thresholds in Establishing a Restricted Charitable Purpose Trust

- Charities should consider whether to require a minimum amount in order to accept a restricted charitable purpose trust
- In determining this threshold, a charity should consider:
  - The cost of administering the trust
  - Whether further contributions of capital to the restricted charitable purpose trust will be permitted, and
  - Whether to impose any limitations on further contributions, such as who may contribute and whether a minimum donation will be required

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### 3. Description of Restricted Purpose

- Restricted purposes that are intended to be permanent must be sufficiently general in scope in order to meet the test of time and changing circumstances
- Consideration should also be given to what will happen when the intended restricted purpose is achieved or is no longer relevant or practical
- A provision that allows the board to vary the restricted purpose should also be included so the board does not need a *cy-près* order
- Determining which restrictions are appropriate and how broadly or narrowly to word these restrictions will require careful drafting, often involving consultation with the charity and the donor

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**4. Assets Forming the Trust**

- The charity must consider what assets the restricted charitable purpose trust will consist of
- For instance,
  - Monies
  - Gifts in kind, such as shares
- The charity must handle different types of property differently, e.g.,
  - Gifts of shares need to be properly evaluated before the gift
  - Gifts of publicly traded shares will be exempt from capital gains tax, but not gifts of private shares

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- Whether cash or a gift in kind, the donor and the charity should consider whether the split receipting and anti-tax shelter provisions of the ITA could affect the fair market value of the gift for receipting purposes
- This would happen through:
  - Deduction of any “advantage” from the fair market value of the gift, or
  - Reduction of the fair market value of the gift through the “grind down” deeming provision applicable to some specific types of gifts in kind in certain situations

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**5. Naming Rights**

- Some donors may wish to build naming rights into the terms of the restricted charitable purpose trust
- If so, the charity must determine:
  - How long the naming rights will last
  - Whether to reserve the right to terminate the naming rights of a donor

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52

- The donor and the charity should also consider whether the naming rights will constitute a taxable "advantage" under the ITA, preventing the donor from obtaining a tax receipt for the full value of the gift
- CRA has generally held that individual naming rights alone do not constitute an advantage
- For a business, if the naming rights amount to sponsorship that promotes the business' brand or products, the naming rights could constitute an advantage that would need to be deducted from the fair market value of the gift
- But, the business could deduct the value of such advantage as a business expense and would therefore be in the same tax situation

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53

### 6. Disbursing Trust Fund

- If there is no time restriction, the charity will generally disburse funds received and interest earned as soon as it is practical
- However, where there is a time restriction, such as with a long term or perpetual endowment, the question becomes whether
  - all of the income earned must be expended on the restricted purpose, or
  - only a portion is to be expended with the balance being capitalized, presumably in order to keep up with inflation

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- Another issue is whether the income to be disbursed includes interest and dividend income only or whether it also includes realized capital gains
- In this regard, the charity should consider using a total return investment model, in which the charity treats all returns from the fund as expendable on an annual basis, whether derived from interest, dividends, or capital gains
- Irrespective of what it prefers, the charity should articulate its preferences in a disbursement policy that it can incorporate into a trust document instead of leaving it to be worked out within the terms of the trust document itself or left to the direction of the donor

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### 7. Donor-Advised Provision

- As discussed earlier in this presentation,
  - It should be made clear to the donor that the board of the charity must exercise ultimate control over the expenditure of the income and capital of the gift
  - Too much control by the donor will defeat the gift, resulting in the donor being unable to have the gift receipted for income tax purposes and possibly even challenged on a subsequent audit of the donor's charitable gifts by Canada Revenue Agency

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### 8. Administration Fee

- Another issue to consider is whether the charity might want to charge a reasonable administrative fee against the income and/or capital of the trust fund
- If so, the charity should:
  - Disclose the fee in the trust document, or
  - Require the trust document to cross-reference the charity's gift acceptance policy, which should set out the fee

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### 9. Investing Trust Monies

- When drafting a restricted charitable purpose trust, gift-planners should become familiar with the charity's investment policy (if there is one)
- A charity's investment policy should stipulate how the capital of a restricted purpose charitable trust will be invested
- In Ontario, the *Trustee Act* requires a charity to have an investment policy if it is delegating investment decisions to an investment manager
- Even if a charity is not delegating investment decision making, it is still advisable for a charity to consider adopting an investment policy

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- A well drafted investment policy will help protect the board from personal liability and help ensure the board meets the requirements in the Ontario *Trustee Act*
- In Ontario, the *Trustee Act* states that "a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments"
- A trustee's investment decisions will be viewed objectively to determine if the standard is met
- If an investment performs poorly, the trustee will not be liable if he or she can demonstrate that the investment was made according to a reasonable assessment of risk and return that a prudent investor would make under similar circumstances

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- When drafting restricted charitable purpose trusts, gift-planners should:
  - Incorporate the charity's investment policies into the trust document, or
  - Allow the donor to impose specific investment terms of reference on the gift, (although the former is preferable)
    - Where the donor imposes specific investment terms, the charity should ensure they are consistent with the "prudent investor" standard set out in the Ontario *Trustee Act*, the charity's investment policy and its charitable purposes

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### 10. Variation of the Trust

- A donor cannot vary the terms of a restricted charitable purpose trust after it has been created, although the donor can retain the ability to provide non-binding input through the terms of the trust
- The charity cannot vary the terms of a charitable trust on its own, unless the document permits
- As such, the trust document must include a provision giving the charity discretion to vary the terms of the restricted purpose, whether such restrictions pertain to use or time
- A gift-planner must ensure the charity receives as much flexibility as possible in this regard

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61

**11. Transfer of Trust Property**

- Gift-planners should also consider including a provision that allows the charity to transfer the trust funds to a subsequent trustee
  - Provided the subsequent trustee is a registered charity and enters into a deed of appointment as contemplated by section 3 of the Ontario *Trustee Act* and other similar provisions in other provincial trustee legislation
- The deed of appointment will ensure that the recipient charity agrees to be bound by all of the terms of the original restricted charitable purpose trust as a subsequent trustee

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**12. Anti-terrorism and Money Laundering Considerations**

- Charities may also need to address due diligence considerations under Canada's broad reaching anti-terrorism and money laundering legislation
- The legislation can significantly impact charities, particularly those operating in conflict zones
- Accordingly, the charity may need to make due diligence inquiries of the donor
- The charity may also want to retain the right *not* to apply the trust monies to the restricted purpose in the event that the charity subsequently has concerns about its ability to comply with anti-terrorism or money laundering legislation with regards to the restriction

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**13. Independent Professional Advice**

- A charity should consider advising the donor in writing to seek independent legal advice and/or tax advice from an accountant or financial planner
- Donors should be informed of this right *before* the gift has been made and have it confirmed in the trust document
- Doing so will reduce the risk of a gift being challenged by the family of the donor alleging undue influence
- The charity should be aware of any other evidence of undue influence in the donor's actions, and should address any concerns before the gift has been made

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#### 14. Considerations When Drafting Board-Created Restricted Charitable Purpose Trusts

- The substantive terms of the trust should be similar to the terms of a donor-created trust
- The trust should be as carefully drafted as the terms of a testamentary or *inter vivos* charitable trust
- Additionally, boards should adopt a resolution authorizing the restricted charitable purpose trust when establishing the terms of the fund

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- Specifically, there should be:
  - A board resolution to authorize each separate board-created trust, or
  - A board resolution to delegate that ability to an authorized officer of the charity if applicable
  - And, lastly, to reduce the risk that the restricted charitable purpose trust will be challenged, the board should take steps to ensure the terms of the trust have been adequately communicated to the donor in writing

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#### F. BASIC MANAGEMENT CONSIDERATIONS FOR DONOR RESTRICTED CHARITABLE GIFTS

- Charities that have established donor restricted gifts need to carefully manage those gifts
- It is therefore important for gift-planners who draft donor restricted gifts to be aware of what the responsibilities are and what restrictions may apply
- As stated earlier, most donor restricted gifts are structured as restricted charitable purpose trusts

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**1. Initial Review of the Gift Document**

- Whenever a charity receives a restricted gift agreement (whether *inter vivos* or testamentary), the charity's managers must carefully review the terms of the donor restrictions
- First, the charity must ensure that the restrictions placed on the gift are actually charitable
  - Restrictions that are not charitable render the entire restricted charitable purpose trust invalid
- The charity must then ensure the restrictions are within the charitable purposes of the charity
  - If a restriction has no relation to the nature and work of the charity, it is a good indication that the charity should not accept the gift

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- The charity must then determine whether the restrictions are possible and practicable
  - It is pointless to have a donor restricted gift with restrictions that make the trust impossible or impractical to administer
  - Determining this at the outset may avoid wasting valuable time and money on managing an unworkable charitable trust
- Lastly, the charity must determine whether the restrictions are, in fact, acceptable to the charity

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- If any of these questions are answered in the negative, the charity should return the donor and no charitable tax receipt should be issued
- If the gift is subject to restrictions that the charity wishes to accept but are either impossible or impractical, the charity will need to a court to have the court exercise its *cy-près* scheme-making power to vary the terms of the restriction "as near as possible" to the original restrictions imposed by the donor
- Once a charity accepts a donor restricted gift, the charity must ensure the funds are managed in accordance with the restriction

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**2. Banking Considerations**

- This may be problematic for charities with parallel foundations, like hospitals, where the hospital wishes to deposit the gift directly into the bank account of the parallel foundation
- Since a donor restricted gift is given to a specific charity, it must be deposited into the bank account of the named charity

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- As well, at common law, gifts subject to restrictions must be kept in separate accounts from other restricted trust funds, as well as from the general bank account
- However, Regulations under the CAA now permits commingling of restricted charitable purpose trust funds if certain requirements are met
  - Combining the funds must advance the administration and management of each of the individual properties,
  - All gains/losses/income/expenses must be allocated rateably to each of the properties on a fair and reasonable basis and in accordance with generally accepted accounting principles, and
  - Specific records must be maintained under subsection 3(5) of the Regulation

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- Regardless, a charity still cannot commingle restricted charitable purpose trust funds with unrestricted general funds
- It is therefore important for the board of directors of a charity to weigh the benefits to be gained from combining restricted charitable purpose trust funds against the significant administrative costs and the aggravation of keeping the necessary records in order to commingle those funds
- It is also important for the board of a charity to realize that commingling restricted charitable purpose trust funds in contravention of the Regulation could expose the directors to allegations of breach of trust and resulting personal liability

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- Furthermore, the charity must ensure that it never borrows against restricted charitable purpose trust funds or other donor restricted funds, whether it be to further other charitable purposes of the charity or to under-write the general operations of the charity, notwithstanding that the board may intend to repay the monies at a later time with interest

**QUESTIONS?**

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