
HEALTHCARE PHILANTHROPY

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CONSIDERATIONS IN DRAFTING AND MANAGING RESTRICTED GIFTS

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CONSIDERATIONS IN DRAFTING AND MANAGING RESTRICTED GIFTS

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INTRODUCTION

- This presentation highlights issues that hospitals and hospital foundations should consider when drafting testamentary or *inter vivos* restricted gifts
- The key element of both testamentary and *inter vivos* restricted gifts is the establishment of the restriction
- The restriction can relate to either how the gift is used or the time when it is applied
- A charity that accepts a gift subject to a restriction is legally bound by that restriction
- A restricted gift to a charity normally consists of a restricted charitable purpose trust
- With restricted charitable purpose trusts, the charity becomes the trustee subject to the legal regime governing charitable purpose trusts

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- Common types of restricted charitable purpose trusts include:
 - Endowments
 - Long term funds
 - Scholarship funds
 - Building funds
 - Research funds
- For more information, see *Considerations When Drafting Restricted Charitable Purpose Trusts* (2010) <http://www.carters.ca/pub/article/charity/2010/tsc1001.pdf> (2012) http://www.carters.ca/pub/article/charity/2011/ETP.J30-4_Carter.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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A. DIFFERENCES BETWEEN AN UNRESTRICTED AND A RESTRICTED CHARITABLE GIFT

- When drafting or managing testamentary or *inter vivos* restricted gifts, it is essential to understand the difference between an unrestricted and a restricted charitable gift
- This difference is essential because significant legal consequences flow from whether a charitable gift is unrestricted or restricted



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1. Unrestricted Charitable Gift

- An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose of a charity that 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
- This means that, provided that the board of a charity does not extend beyond its charitable purposes, the charity may use the gift as it wishes in its discretion

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- 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 the charitable objects of the charity

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2. Restricted Charitable Gift

- 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 the 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
- As is explained later in this presentation, 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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B. DIFFERENT TYPES OF RESTRICTED CHARITABLE GIFTS

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 purposes
- A charity can only use the gift to accomplish the specific charitable purpose established by the donor

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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 of "in trust" is required
- In *Rowland v. Vancouver College*, Levine J. determined that the requirements are less formal and could 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 given, 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 possibly 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 in the form of a disbursement policy

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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 as soon as is practical
- Use restrictions often require the gift be applied to:
 - A particular capital use (e.g. a building program)
 - Or 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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D is for donors

- 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 i.e. children, provided that such beneficiary group is not too small, e.g. children who live on one street
 - In such a situation, the board must ensure the restrictions are not repugnant or contrary to public policy, such as discrimination against a disadvantaged group
- Donors can include a use restriction along with a time restriction as well, or both

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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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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 not 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 by 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 restrictions 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 restriction
- The difficulty arises when donors use less than clear or contradictory terminology - in which event, professional advice is recommended

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- Unlike precatory trusts, the donor of a donor-advised fund will have ongoing input but not direction into how the funds can be 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 coupled with ongoing input from the donor
- This can be a problem, though, if the donor retains defacto control, the fund may not be considered a gift at law and therefore could not 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 have similarities to restricted charitable purpose trusts because a restriction is imposed
- However, the charity becomes the beneficial owner of a conditional gift, either after the condition has been fulfilled or until a condition subsequent occurs
- Conversely, a charity does not become 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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- 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"
- 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

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- 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
- 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 Toronto by the year 2014"

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4. 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

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

- As explained, 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


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 10 years or more 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 actually 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 are to be permitted and from who



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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 to apply for 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 is made for receipting purposes
 - 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 a gift in kind through the “grind down” deeming provision applicable to 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
- 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



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- 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 position as if it had received a charitable receipt

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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 model for disbursement 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 the gift agreement instead of leaving it to be worked out within the terms of the gift agreement itself or left to the direction of the donor

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7. Donor-Advised Option


- A donor-advised provision may be an attractive option for donors who want ongoing involvement
- As discussed earlier,
 - It should be made clear to the donor that the board of the charity must exercise control over the expenditure of the income and capital of the gift
 - Defacto 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 administration fee against the income and/or capital of the trust fund
- If so, the charity should:
 - Disclose the fee in the gift agreement, or
 - Require the gift agreement to cross-reference the charity's gift acceptance policy, which should set out administration fee particulars



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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 reflecting the *Trustee Act*

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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 *Trustee Act*
- 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 gift agreement, 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 as well as the charitable purposes of the charity

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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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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 *Trustee Act*
- 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. 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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13. 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 gift agreement
- 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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D. CONSIDERATIONS IN MANAGING RESTRICTED CHARITABLE GIFTS

- Charities that have established donor restricted charitable 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 apply 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. Depositing Funds

- It will be problematic for charities with parallel foundations, like hospitals, where the hospital or foundation wishes to deposit a gift to the hospital 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
- Otherwise, the gift may not be considered complete leaving its board of directors exposed to personal liability



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3. Commingling Restricted Funds


- 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 permit commingling of restricted charitable purpose trust funds if certain requirements are met, such as
 - 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
- 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
- As well, the charity must never borrow 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 even if the board intends to repay the monies at a later time with interest

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