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**CONSIDERATIONS WHEN DRAFTING
RESTRICTED CHARITABLE PURPOSE TRUSTS**

Terrance S. Carter
Carters Professional Corporation

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A. INTRODUCTION¹

The phrase “charitable purpose trusts” can be confusing, since it can have a number of different applications. Generally, charitable purpose trusts involve one of four applications:

1. A charitable purpose trust can be used as a legal structure to establish and operate a charity through the execution of a trust document or trust instrument.² This legal structure is recognized for the purpose of obtaining registered charitable status by Canada Revenue Agency (“CRA”),³ the regulator responsible for the registration of charities under the *Income Tax Act* (“ITA”).⁴
2. A charitable purpose trust can also be utilized to establish a charity through the establishment of a testamentary trust as part of a testator’s will.⁵

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¹ This paper is based in part on Terrance S. Carter, “Donor-Restricted Charitable Gifts: A Practical Overview Revisited II” (presented for the Canadian Association of Gift Planners at the *2006 Annual National Conference*, 2006), online: <http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>.

² For a discussion of charitable trusts as a legal structure, see Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, 3rd ed. (Markham: Butterworths, 2002) at 37-40.

³ Canada Revenue Agency, “T4063: Registering a Charity for Income Tax Purposes” (December 9, 2008), online: <http://www.cra-arc.gc.ca/E/pub/tg/t4063/t4063-08e.pdf> at p10.

⁴ R.S.C. 1985, c. 1 (5th Supp.).

⁵ For more information on gifts made by a testator involving trusts, see M. Elena Hoffstein and Theresa L.M. Man, “Charitable Donations Made Through Wills” (May 1, 2007), online: <http://www.carters.ca/pub/seminar/charity/2007/mehtlm0501.pdf>.

3. As well, a will can establish a testamentary restricted charitable purpose trust to be held by a charity, as opposed to establishing a charity, which trust can be restricted by either time (i.e., a testamentary gift to a charity to establish a perpetual endowment) or direction of use (i.e., a testamentary gift “to a charity to support its cancer research”).
4. Finally, a charitable purpose trust can be utilized to create an *inter vivos* restricted charitable purpose trust to a charity, which is a gift made during the lifetime of the donor, rather than upon the donor’s death, that involves either a restriction dealing with time or use. An example of an *inter vivos* restricted charitable purpose trust would be a gift to a charity by a donor in support of its relief work in Africa.

It is not possible to cover all aspects of these four types of charitable purpose trusts within the parameters of a continuing legal education seminar paper. As a result, this paper will focus primarily on the third and fourth type of trusts, i.e. testamentary and *inter vivos* restricted charitable purpose trusts, as these trusts tend to be the most prevalent types of charitable purpose trusts that estate and trust practitioners will be asked to draft. However, the comments that follow will also have application in part to the other two types of charitable purpose trusts, particularly as they apply to the imposition of restrictions.

The key element of both testamentary and *inter vivos* restricted charitable purpose trusts is the establishment of the restriction, whether the restriction is with regards to the use or with regards to the time during which the charitable gift is to be applied. If a charity accepts a gift subject to a restricted charitable purpose trust, the charity is legally bound by those restrictions. This form of gift, whether the charity understands it or not, establishes a special purpose charitable trust within the charity itself and the charity, as trustee, is subject to the legal regime governing such trusts. Common types of restricted charitable purpose trusts include endowments, long term funds, scholarship funds, building funds, as well as donor advised funds that are often placed with community foundations, to name a few examples.

As donors become more sophisticated with their giving and demand more accountability from charities, the use of restricted charitable purpose trusts is becoming a more frequent fundraising vehicle, particularly for donors making large gifts to charities. Many charities in Canada, though,

do not fully appreciate the legal implications of accepting restricted charitable purpose trusts. Failing to honour the restrictions imposed by such trusts could expose the charity, and its directors or trustees, to liability for breach of trust. As well, failure to comply with the restrictions has the potential to erode donor confidence and undermine the credibility of the recipient charity as well as the charitable sector in general. The aim of this paper is to provide estate and trust practitioners with an understanding of charitable purpose trusts that are subject to restrictions in the context of *inter vivos* and testamentary trusts, an understanding of possible areas of liability for lawyers advising on or drafting such charitable purpose trusts, and practical tips to consider when drafting restricted charitable purpose trusts.

This paper, though, is not intended to be comprehensive in terms of the issues that lawyers will need to consider when drafting restricted charitable purpose trusts. Instead, the paper highlights only some of the more common issues that lawyers should be aware of in advising both donors and charities when drafting the provisions of the trust. As always, lawyers must take the time to tailor the restricted charitable purpose trust to fit the factual context and needs of the particular donor or charitable client as the case may be.

B. WHAT ARE THE BASIC ATTRIBUTES OF A CHARITABLE PURPOSE TRUST?

Before a restricted charitable purpose trust can be drafted, it is important to understand what a charitable purpose trust is. This section of the paper therefore describes some basic trust law principles to assist the practitioner in understanding the fundamental components of a charitable purpose trust.

Charitable purpose trusts have their origin in the medieval concept of the “public use”, as opposed to the “private use.” The public use eventually evolved into the charitable trust.⁶ The definition of a charitable purpose trust is tripartite: it is an exclusive dedication of property to a charitable purpose in a way that provides a public benefit. Although Anglo-Canadian law does not provide a conceptual definition of charity, there are four categories of charitable purposes

⁶ See G. Jones, *History of the Law of Charity, 1532-1837* (Cambridge: Cambridge University Press, 1969).

recognized by the courts: the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community.⁷

Before looking at the specifics of a charitable purpose trust, it is necessary to first review the basics of trust law. A trust is usually established by a trust document or instrument, and must include three essential components or “certainties” to create the trust: certainty of intention, certainty of subject matter, and certainty of object. For charitable trusts, a trust document will typically set out what the purpose of the objects of the trust are, what property is to be held in trust, what the criteria are that will be used to determine the beneficiaries or the purpose of the trusts, and how the trust property is to be managed by the trustees for the benefit of the specified persons or for the specified purposes.⁸

The term “charitable purpose” is generally used in the context of a charitable purpose trust, but has application to other legal forms of charities as well. *Restatement of Trusts*⁹ defines a charitable purpose trust as follows:

A charitable purpose trust is a fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose.

The Ontario Law Reform Commission, in its 1996 seminal *Report on the Law of Charities*, summarized the basic nature of a charitable purpose trust as follows:

...a promise or undertaking made by the initial trustee, followed by undertakings of his or her successor trustees, to apply a certain locus of wealth, sometimes in perpetuity, to a particular purpose. So analyzed, it is more akin to an oath or a vow, albeit legally enforceable, than to a bilateral contract. It is this feature that gives it its special and problematic judicial character.¹⁰

⁷ For a more detailed discussion of the four categories of charitable purposes, see *Income Tax Special Purposes Commissioners v. Pemsel*, [1891] A.C. 531 (H.L.) and *Vancouver Society of Immigrant and Visible Minority Women v. Canada (Minister of National Revenue)*, [1999] 1 S.C.R. 10. See also Mark R. Gillen and Faye Woodman, *The Law of Trusts: A Contextual Approach*, 2nd ed. (Toronto: Emond Montgomery, 2008) at 231-271.

⁸ Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, *supra* note 2 at 37. See also Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *Waters' Law of Trusts in Canada*, 3rd ed. (Toronto: Thomson Canada, 2005), c. 14.

⁹ American Law Institute, *Restatement (Second) of Trusts* (Washington, D.C., 1959) at para. 348.

¹⁰ Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ministry of the Attorney General, 1996) at 395.

The relationship between the trustees and the charitable trust and its beneficiaries is a fiduciary one, and the trustee has substantial obligations imposed upon them as a result of the fiduciary relationship.¹¹ In this regard, the fundamental obligation of a trustee is to hold the trust property for the benefit of the trust objects in accordance with the specific terms of the trust. When the trust objects are identifiable persons, those persons are entitled to compel the trustee to act in their best interests in accordance with 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. For this reason, the general law is that trusts for purposes are not valid. However, there is an exemption made for charitable purpose trusts on the basis that the Crown, as *parens patriae* for charities, has the power to enforce the performance of the trust. In Canada, the Crown's prerogative is exercised by the Attorney General or the Public Guardian and Trustee for each Province. It may be that the Attorney General or the Public Guardian and Trustee is less inclined to diligently monitor the performance of charitable purpose trusts than an individual who is personally interested in a private trust. The fact that enforcement of charitable purpose trusts may be less vigorous than private trusts does not, however, change the nature of the trustees' legal obligations or the potential liability for a breach of trust.¹²

The trustees of a charitable purpose trust, like the trustees of any other trust, are also subject to general trust law principles governing the administration of the trust. Thus, for example, at common law, the assets held pursuant to a charitable purpose trust must be segregated from the other assets held by the trustees unless the terms of the trust expressly permit co-mingling.¹³ A trustee must carry out his or her tasks honestly and with due care and attention. The trustee must also carry out the duties personally, and only under limited circumstances may delegate his or her responsibilities to another person. Additionally, the trustee must place the interests of the beneficiaries or the purpose of the charitable trust first and not permit his or her own interests to conflict in any way with the duties to the beneficiaries or the purpose of the charitable trust.¹⁴ At all times, the trustee must be ready to provide "full explanations of all of their dealings, and of

¹¹ Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, *supra* note 2 at 40.

¹² M. Elena Hoffstein, Edgar A. Frechette, and Terrance S. Carter, "Endowed and Restricted Gifts: What the Gift Planner Needs to Know" (2003), online: <http://www.carters.ca/pub/seminar/charity/2003/CAGP0501.pdf> at 4.

¹³ O. Reg. 4/01, s.3; See also Terrance S. Carter, "Ontario Releases Regulation under the *Charities Accounting Act*" in *Charity Law Bulletin* No. 1 (February 1, 2001), online: <http://www.carters.ca/pub/bulletin/charity/2001/chylb01-01.pdf>.

¹⁴ Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, *supra* note 2 at 40.

the cause why outstanding assets were not collected, or property of the estate has disappeared.”¹⁵ Although only the Attorney General or Public Guardian and Trustee can compel the trustee to provide an accounting, it is a practical necessity that charities be willing and able to properly account to donors for the administration of charitable purpose trusts.

Compared to other forms of trusts, a charitable purpose trust has certain beneficial attributes which are unique to it. Those attributes can be summarized as follows:

- A charitable purpose trust is an exception to the rule that purpose trusts are void.
- A charitable purpose trust is exempt from the requirement that there be a beneficiary of the trust. In Ontario, this means that there is no one to enforce the trust other than the Public Guardian and Trustee, under the authority of the Attorney General, in accordance with that office’s traditional *parens patriae* role in overseeing charitable purposes.
- A charitable purpose will not fail for uncertainty of objects, even though there are no identifiable beneficiaries, provided that the purpose is exclusively charitable. Trustees for charitable trusts may be given discretion to make a determination about whether or not an individual is one of the intended beneficiaries.¹⁶
- The court is prepared to write or rewrite a charitable purpose trust in certain limited circumstances by supplying a *cy-près* scheme, i.e., by making the charitable objects “as near as possible” so that the charitable purpose intended by the donor can continue to be achieved.¹⁷
- The prohibition against remoteness of vesting, otherwise known as the “modern” rule against perpetuities, does not apply to charitable purpose trusts.
- A charitable purpose trust is exempt from the prohibition against indestructible or perpetual trusts. This rule would otherwise prohibit the tying up of capital in trust where

¹⁵ *Chrisholm v. Bernard* (1864), 10 Gr. 479 at 481.

¹⁶ *Jones v. T. Eaton Co.*, [1973] S.C.R. 635. See also Donald J. Bourgeois, *supra* note 2 at 39.

¹⁷ Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *supra* note 8 at 642.

it is impossible to identify the absolute equitable owners for a period greater than the perpetuity period. This means that both property and funds held by a charity can be held in perpetuity without violating any rule of law.¹⁸

- The rules of law and statutory enactments relating to accumulations do not apply to charities.¹⁹
- Perhaps the best-known advantages accorded to charities are those that derive from taxing statutes. The ITA, for example, exempts the income of registered charities from tax and allows registered charities to issue receipts for donations, thus enabling the tax payer to claim a tax credit for the money given if the tax payer is an individual and a tax deduction if it is a corporation.²⁰

However, there are also some restrictions on the use of charitable purpose trusts. For example, a charitable purpose trust must be devoted exclusively to charitable purposes. If not, the trustee would have the discretion to use the funds for either charitable or non-charitable (i.e., invalid) purposes, and therefore the trust would be void. Many cases that address whether a trust is devoted exclusively to charitable purposes focus on the wording of the trust, because the courts have interpreted terms such as “objects of liberality”,²¹ “benevolent objects”,²² and “philanthropic purposes”²³ as not referring exclusively to charitable purposes. In every case, a court will search for the expressed intention of the creator of the trust. In this regard, drafters of

¹⁸ For a discussion of the rule against perpetuities, see Adam Parachin, “Charities and the Rule Against Perpetuities,” (2008) vol. 21, no. 3 *The Philanthropist* at 256. This paper was also presented at the 2007 National Charity Law Symposium on May 10, 2007.

¹⁹ *Accumulations Act*, R.S.O. 1990, c. A.5, s. 4. For more information on the changes caused by the *Good Government Act, 2009*, see Terrance S. Carter, “Bill 212 Brings Significant Reform to the Regulation of Charities in Ontario” in *Charity Law Bulletin* No. 181 (November 26, 2009), online:

<http://www.carters.ca/pub/bulletin/charity/2009/chylb181.htm>. See also Terrance S. Carter, “Good News - Bill 212 Receives Royal Assent” in *Charity Law Update* (December 2009), online:

<http://www.carters.ca/pub/update/charity/09/dec09.pdf> and Terrance S. Carter, “Breaches of Charitable Gifts Act ‘Cured’ by Good Government Act” in *Charity Law Update* (January 2010), online: <http://www.carters.ca/pub/update/charity/10/jan10.pdf>.

²⁰ *Supra*, note 4, ss. 118.1 and 110.1, as amended, establishes the tax credit and the deductibility of donations by individuals and corporations to “registered charities”, which are defined in s. 149.1.

²¹ *Morice v. Bishop of Durham* (1804), 32 E.R. 656 at 658.

²² *Chichester Diocesan Fund and Board of Finance Inc. v. Simpson*, [1944] A.C. 341 (H.L.).

²³ *Brewer v. McCauley*, [1954] S.C.R. 645.

charitable purpose trusts have a responsibility to ensure that the wording of the trust is sufficient to uphold the finding of a charitable purpose trust.²⁴

Furthermore, trusts for political purposes (even if otherwise for charitable purposes) are invalid. “Political purposes” does not mean only direct political party activity; it also includes the promotion of political ideas and any attempts to influence the legislative or executive process. Although some commentators have been critical of the political purposes doctrine, it remains alive and well in Canada.²⁵

Lastly, while the trust structure is not necessarily in itself expensive to establish or to operate, it may actually serve to increase the potential exposure of trustees in comparison to other legal structures. Although the duties of a trustee are similar in nature to the duties of a director of a corporation without share capital (especially a “charitable non-share capital corporation”), the standard of care is higher for trustees, in particular trustees of a charitable purpose trust, than it is for directors and officers of a corporation or even of an unincorporated association.²⁶ For this reason, it is important that lawyers advising clients who wish to establish a restricted charitable purpose trust or who are managers of such trusts understand the obligations and duties imposed on the trustees by both the applicable statutory provisions and at common law.

C. WHAT ARE THE DIFFERENCES BETWEEN AN UNRESTRICTED AND A RESTRICTED CHARITABLE GIFT?

When drafting testamentary or *inter vivos* restricted charitable purpose trusts, it is important to understand the broader context of unrestricted charitable gifts as compared to restricted charitable gifts, of which restricted charitable purpose trusts are one type. The specific characteristics of restricted charitable purpose trusts are explained in the next section of this paper.

²⁴ See Gillen and Woodman, *supra* note 7 at 271-276 for a more detailed discussion of the requirement of exclusive purposes.

²⁵ See, for example, *Human Life International in Canada Inc. v. Minister of National Revenue*, [1998] 3 F.C. 202 (F.C.A.), leave to appeal to S.C.C. refused, [1998] S.C.C.A. No. 246.

²⁶ Donald J. Bourgeois, *supra* note 2 at 48.

1. Unrestricted Charitable Gifts

An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose (whether the charitable purpose is in the form of a charitable purpose trust, a charitable corporation, or a charitable unincorporated association) that is not subject to any restrictions imposed either directly or indirectly by the donor, other than the legal requirement that the gift be used for the charitable purpose of the recipient charity in question. As a result, the board of a charity is at liberty to apply an unrestricted gift to its charitable purposes as stated in its constating documents without restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would fetter or limit the discretion of the board in applying the gift in whatever manner it deemed to be most appropriate to achieve its charitable purpose.

This means that, provided the board of a charity does not exceed its charitable purposes, whether through the breach of a fiduciary duty with regard to the general trustee-like obligations in dealing with its charitable property or embarking on *ultra vires* activities that are beyond the objects of the corporation, 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. In addition, if the board of a charity decides to designate unrestricted charitable gifts for a specific charitable purpose, there is nothing to stop the board from subsequently undesignating the funds and applying the funds to another charitable purpose within its charitable objects.

Unrestricted charitable gifts form a broader category of gifts than do restricted charitable gifts, since unrestricted charitable gifts include all sources of monies gifted to a charity that are not subject to donor restrictions. The following are some examples of unrestricted charitable gifts:

- 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 are directed to be used “for the general purposes of the charity,” or alternatively where there is a gift to a charity and there are no references to restrictions, conditions, limitations or restrictions attached to the gift at all;

- Board-designated funds consisting of unrestricted charitable gifts that have been designated by the board for a particular purpose or held as a board initiated endowment fund.

With all of the above funds, and in particular in relation to board-designated funds, it is open to the board of the charity to vary, 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.

2. Restricted Charitable Gifts

For purposes of comparing restricted and unrestricted 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.²⁷ These limitations are imposed by the donor and serve to constrain or limit a charity concerning how the gift can be used.

While unrestricted charitable gifts are beneficially owned by a charity for its general charitable purposes, restricted charitable gifts, when structured as a restricted charitable purpose trust as opposed to other forms discussed below, are held by the charity in trust for the purposes specified by the donor and are not actually owned beneficially by the charity. In that situation the charity is, in fact, holding the gifted property subject to a specific charitable purpose trust within the confines of its own general charitable purpose (in essence a charity within a charity). Although for trust law purposes each restricted charitable purpose trust is a separate trust, as long as the trustee is already a registered charity a charitable purpose trust is not required to be registered by Canada Revenue Agency as a separate registered charity.²⁸

The board of a charity that receives a restricted charitable gift needs to be careful to identify the nature of the donor restriction and to recognize the legal consequences of the specific type of

²⁷ See also *Black's Law Dictionary*, 8th ed., s.v. "restrict" and "restriction", which is defined as "To restrain within bounds; to limit; to confine."

²⁸ Canada Revenue Agency, "Summary Policy CSP-R22: Restricted Fund", (September 3, 2003; revised November 23, 2005), online at: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/csp/csp-r22-eng.html>. For an explanation regarding how this applies to restricted charitable purpose trusts, see Terrance S. Carter, *supra* note 1 at 12.

restriction that has been imposed by the donor, as well as the importance of complying with the restrictions in question. Sometimes lawyers advising charitable clients may not identify or adequately understand the nature of the donor restriction that has been imposed. This, in turn, can expose charities and their boards of directors to unnecessary and potentially serious liability.

D. WHAT ARE THE DIFFERENT TYPES OF RESTRICTED CHARITABLE GIFTS?

Before drafting a testamentary or inter vivos restricted charitable purpose trust, it is important to understand the different types of restrictions that can be imposed. In this regard, it is also important to understand that not all restrictions associated with charitable gifts necessarily involve a restricted charitable purpose trust. For instance, a gift subject to a condition subsequent (i.e., “I give \$100,000 to Hospital A on the condition that Hospital A commences construction of a cancer wing prior to January 1, 2011”) will involve the imposition of a restricted gift by the donor but the restriction in the form of a condition precedent will not constitute a restricted charitable purpose trust. As such, it is necessary to understand the differences between a restricted charitable purpose trust in its various forms as compared to other types of restricted charitable gifts in order to better understand what can be imposed as restrictions on a restricted charitable purpose trust and what cannot be. In this regard, this section of the paper will discuss the restrictions that apply to restricted charitable purpose trusts by utilizing the term “special purpose charitable trusts,” which is the specific terminology that the courts normally use when referring to a restricted charitable purpose trust. In the next section of the paper, an explanation is provided concerning other types of restricted charitable gifts for comparison purposes, including donor-advised funds, precatory trusts, conditional gifts, determinable gifts, and gifts subject to direction under the *Charities Accounting Act*.²⁹

1. Special Purpose Charitable Purpose Trusts

In general terms, when the courts refer to a special purpose charitable trust, they are meaning 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. The board of a charitable corporation would be acting outside of its authority (whether it be *ultra vires* where the doctrine still applies or simply a breach of fiduciary duties where it does not apply) if it were

²⁹ R.S.O. 1990, c. C.10.

to authorize the corporation to hold property as a special purpose charitable trust where such purpose was outside the scope of the charity's corporate objects.

To the extent that a gift constitutes a special charitable purpose trust, the charity can only use the gift to accomplish the specific charitable purpose established by the donor and for no other purpose. The Supreme Court of Canada has confirmed this common law principle:

The 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.³⁰

Special purpose charitable trusts are also commonly referred to as “donor-restricted trust funds”, “charitable trust property”, “charitable purpose trusts”, “restricted charitable purpose trusts”, “restricted funds”, “special purpose funds”, and sometimes as “endowment funds.” As indicated above, the general terminology that will be used in this section of the paper is “special purpose charitable trusts.” Both traditionally and in practice, a special purpose charitable trust is considered to have been established when the donor has expressed an intention that the property being given to the charity is to be held for a specific charitable purpose, such as when money has been raised for an endowment program or through a public fundraising appeal for a specific project. However, there are conflicting approaches concerning what type of evidence will be required to establish that the donor had the necessary intent to in fact create a special purpose charitable trust. In *Christian Brothers of Ireland in Canada (Re)*,³¹ Blair J. held that there is a higher, more formal standard that is required, whereas in *Rowland v. Vancouver College*,³² Levine J. determined that the applicable requirements are less formal and can involve consideration of all relevant circumstances involved in making the gift.

Blair J. stated that before there can be a “true” special purpose charitable trust, the trust must first be established with the general formal requirements of trust law: certainty of intention, certainty of subject matter, and certainty of objects. In addition to requiring all the formalities of trust law, Blair J. confirmed that all gifts received by a charity are presumed to have been received by it beneficially for its general charitable purposes, unless there is evidence that gives rise to the

³⁰ *Guaranty Trust Company of Canada, Executor of the Estate of Dorothy Elgin Towle v. Minister of National Revenue* (1966), 67 DTC 5003 (S.C.C.).

³¹ (1998), 37 O.R. (3d) 367 (Ont. Ct. (Gen. Div.)) [*Christian Brothers Gen. Div.*], rev'd (2000), 47 O.R. (3d) 674 (Ont. C.A.) [*Christian Brothers C.A.*].

³² (2000), 78 B.C.L.R. (3d) 87 (S.C.), aff'd (2001), 94 B.C.L.R. (3d) 249 (C.A.) [*Christian Brothers B.C.S.C.*].

creation of a special purpose charitable trust (meaning where it was created in accordance with the above-noted formalities). Blair describes gifts where donors have not formally expressed an intention sufficient to create a special purpose charitable trust to be “precatory trusts.”

However, the approach taken by Levine J. ignores the formalities required by Blair J., and instead adopts a more traditional approach concerning what is required to create a special purpose charitable trust. Levine J. states that the required intention to create a charitable purpose trust is not dependent upon the utilization of technical words, such as “in trust”, but rather requires that the court look at all of the relevant circumstances to determine the real intention of the donor. Levine cites *Waters’ Law of Trusts in Canada* with approval, which states that “there is no need for any technical words or expressions for the creation of a trust.”³³

The dichotomy between the approaches of Blair J. and Levine J. remains unresolved. Until further judicial guidance is available on this matter, it would be prudent for legal counsel to be careful in ensuring that the formalities required for the creation of a special purpose charitable trust are carefully articulated in the document creating a restricted gift, whether it be through an *inter vivos* gift agreement or by means of a testamentary gift. Specifically, it would be important to clearly categorize the gift as being a special purpose charitable trust by naming the charity as the trustee, describing the property that constitutes the gift to be held in trust by using the words “in trust”, and explaining the specific charitable purpose for which the property is to be used. Failure to do so by lawyers 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 create a binding special purpose charitable trust capable of effectively restricting the charity in the future.

What now follows is a description of different types of special purpose charitable trusts.

a) Long-Term Gifts, Including Endowments

One type of restriction applicable to a special purpose charitable trust is a restriction involving the length of time that a gift is held, generally in the context of creating some type of long-term gift. In this regard, a long-term gift to a charity is a gift where the capital is held in trust, in whole

³³ Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *supra* note 8 at 132.

or in part for a period of time, where the income and eventually the capital is used either for a specific application, like a scholarship, or for the general charitable purposes of the charity. Some long-term gifts are directed to be held in perpetuity as endowments, while others are to be held for a fixed number of years. Long-term gifts can be subject to a possible right of encroachment by the charity on the capital during the hold period if the donor has built that right within the wording of the gift agreement. Once the hold period has expired (except where the donor directs that the gift be held in perpetuity with no right of encroachment), the entire gift can be disbursed by the charity.³⁴

An endowment is the extreme form of a long-term gift. It is generally considered to be a special purpose charitable trust through which the donor requires that the capital of the gift be held in perpetuity. Since one of the advantages of a charitable purpose trust is the exemption from the rule against indestructible or perpetual trusts, a charity is able to accept gifts where the capital is held in trust on a perpetual basis. This method of charitable funding is not available to a non-profit organization under s.149.1 (1) of the *ITA*, since a non-profit organization does not constitute a charitable purpose trust at law.

The capital of a long-term gift, including an endowment fund, is normally invested in accordance with either the investment terms contained in the document creating the gift or in accordance with the investment powers of the charity as set out in its constating documents or in an investment policy that has been adopted by the charity. Whether or not a portion of the income that is earned from an investment will be capitalized and reinvested will depend upon either the terms in the gift agreement or the investment policy established by the board of the charity in accordance with its corporate investment powers. Unless the terms of the long-term gift require that all of the earned income is to be disbursed, it is normal for the board to provide that a portion of the income is to be reinvested so that the capital of the long-term fund, particularly with an endowment, will at least keep up with inflation and will preferably increase on a net basis over the years.

³⁴ Robert Hayhoe, "A Sketch of the Income Tax Treatment of Endowments," (2010) vol. 23, no. 1 *The Philanthropist*, online:
http://www.millerthomson.ca/docs/A_Sketch_of_the_Income_Tax_Treatment_of_Endowments.pdf.

How the income earned on a long-term gift is applied depends upon whether the donor has expressed a specific direction concerning disbursement of income in the gift agreement or, alternatively, whether the board has established terms of reference concerning how income from a long-term gift is to be applied. In either scenario, the board must ensure that the income is applied only towards the charitable purposes of the charity. To the extent that the donor has not established restrictions concerning how the income from the long-term fund is to be used, the board of a charity will be at liberty to apply the income to any of its charitable purposes as determined by the board from time to time.

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. These three methods also apply to other types of special purpose charitable trusts described later in this section of the paper. When the long-term fund is initiated by the donor, it will normally involve the donor leaving money through a testamentary gift or, alternatively, creating a long-term fund by means of an *inter vivos* gift agreement. If a long-term gift agreement is utilized, whether it be one supplied by the charity or one drafted by the donor's legal counsel, issues such as investment and management of the long-term fund, the name of the long-term fund, as well as disbursement of the income from the long-term fund will normally be addressed. These issues are discussed in more detail later in Section G of this paper.

Alternatively, when the board of a charity takes steps to create a long-term fund itself, it usually advises potential donors that a long-term fund, including an endowment fund, has been established by the charity and invites donors to contribute to it. Another example of a board-created long-term fund is where the board sets aside unrestricted funds and directs that they be applied to a specific purpose. The board will establish the terms of reference for the long-term fund, including how the income will be disbursed and how the fund will be invested. It will also normally have a descriptive name associated with such fund, such as "The Scholarship Fund", or "Research Fund", so that prospective donors can identify it when making a contribution.

In the third type of long-term fund, the board invites donors to establish individual long-term funds with the charity. This allows the donor (within the parameters of the charitable purposes of the charity and subject to the approval of the charity) to structure the long-term fund, including a

perpetual fund, on a more customized basis, subject of course to the approval of the board of the charity. This type of long-term gift is often encountered with community foundations and may involve the donor being able to name the long-term fund and permit family members and friends to make additional contributions of capital from time to time.

To the extent that the board of a charity contributes any of its unrestricted charitable funds to a long-term fund of its own creation and reserves the right to redesignate these funds to a different application at a later time, such a contribution would constitute a co-mingling of restricted trust funds and unrestricted funds and would be prohibited at common law. In a similar vein, any monies that are contributed by donors to either a board-initiated long-term fund or a fund that is initiated by the donor in accordance with the formal requirements of a special purpose charitable trust cannot be applied to a different purpose at the direction of either the board or the donor without court approval unless the terms of the gift agreement or the terms of the board-initiated fund provide the charity with the ability to vary the terms of the long-term gift.

When considering drafting a long-term gift, it is important to be aware that until recently in Ontario, the income of a gift was subject to the ordinary rules that precluded accumulations for longer than 21 years.³⁵ The rule against accumulations provides that no disposition of property may direct the accumulation of income deriving from that property for any period of time longer than the permissible accumulations period. The *Accumulations Act* provides for six possible accumulation periods,³⁶ and if the terms of the trust provided for the accumulation of income beyond one of those six periods, the charity was forced to distribute the income in a prescribed manner.³⁷ This was a concern for charities holding property in trust on a long-term basis on terms that allowed for the capitalization of income to be derived from property.

However, the recent passage of the *Good Government Act, 2009*,³⁸ has amended Ontario's *Accumulations Act* so that "[t]he rules of law and statutory enactments relating to accumulations do not apply and shall be deemed never to have applied to trusts created for a charitable purpose, as defined in section 7 of the *Charities Accounting Act*."³⁹ This is welcome relief for charities

³⁵ See the *Accumulations Act*, *supra* note 19.

³⁶ *Ibid.*, s. 1(1).

³⁷ *Ibid.*, s. 1(6).

³⁸ *Good Government Act, 2009*, S.O. 2009, c. 33.

³⁹ *Ibid.*

operating in Ontario, as they no longer have to be concerned with drafting restricted charitable purpose trusts in a way that avoids the application of the *Accumulations Act*.⁴⁰

b) Restricted-Use Gifts

Unlike long-term funds, restricted-use funds do not require that the capital of a gift be held in trust for a specific period of time, although a time restriction can apply as well. Instead, the capital, as well as income, will be applied in accordance with applicable charitable purpose restrictions, and the capital and income will be applied either immediately or over a relatively short period of time (such as with a building fund), so that the restrictions will eventually be fulfilled, thereby bringing the special purpose charitable trust fund to an end.

Common use restrictions imposed by donors in this regard include restrictions concerning how a gift will be applied to further a particular capital use, such as a building program, or an operational use, such as a relief effort in a foreign country. In either situation, it is essential that the use restrictions established be within the parameters of the charitable purpose set out in the charity's constating documents. If this is not the case, then the board of the charity will be in breach of trust and will be liable for having authorized an *ultra vires* activity outside of the corporate authority of the charity if it is a charitable corporation and the doctrine of *ultra vires* still applies. A use restriction can be combined with a time restriction, such as a long-term gift as described above (including an endowment). An example of a combination would be a scholarship fund for music students to be held for at least 20 years.

Donors may also establish use restrictions concerning the manner in which the charitable objects of a charity are to be carried out. For instance, donors may establish restrictions that do not limit what the charity can do, but rather who is entitled to benefit from its activities. In such a situation, it is important that the board ensure that the restrictions are not void as being repugnant or contrary to public policy, such as restrictions that are discriminatory. The general law is that any restrictions that are discriminatory will be void unless they discriminate in favour of historically disadvantaged groups (eg. women, people of colour).⁴¹ The courts, however, have

⁴⁰ For more information on the changes wrought by the *Good Government Act, 2009*, see Terrance S. Carter, *supra* note 19.

⁴¹ See, for example, *Levy Estate (Re)*, [1989] O.J. No. 660 (Ont. C.A.) and *Canada Trust Co. v. Ontario (Human Rights Commission)* (*sub. nom. Leonard Foundation Trust*) (1990), 74 O.R. (2d) 481 (C.A.).

found that certain types of restrictions that prefer one class of persons are not void. For example, one case addressed gifted property that was to be used to provide bursaries to Catholic students. The Court held that the discriminatory language was “relatively innocuous” and was not offensive to the degree necessary to warrant undermining the testator’s right to testamentary freedom.⁴²

As with long-term funds, restricted-use funds can be established at the initiation of the donor, either through an *inter vivos* or testamentary gift that includes a time or a use restriction, or both. Alternatively, the board of a charity can take the initiative in establishing a restricted-use fund by inviting donations from supporters or from the public for a specific purpose. Provided that the wording used to establish the restricted fund meets the formal requirements of a trust, the monies received will generally constitute a restricted charitable purpose trust to be used in furthering a designated charitable purpose, such as a building program for a new church or a new wing for a hospital.

For the charity, restrictions on how gifted property can be used raise a number of issues that should be carefully considered before the charity accepts the gift. One issue is whether the restricted gift is exclusively charitable. If the restriction requires that the gifted property can be used in a manner that is not exclusively charitable, then the trust is invalid and the gift fails. Determining whether or not particular restrictions on the use of gifted property are exclusively charitable is not always easy, as there is no precise legal definition of what is charitable. Instead, the gifted property must be able to be used in a manner that falls within one of the four general heads of charity, as discussed earlier in this paper.

In addition to falling within one of the four heads of charity, the particular use of gifted property must be for the public benefit, meaning that it must benefit the public at large or a significantly large section of the public.⁴³ Over the years, there have been many cases which have considered whether a particular restricted purpose falls within one of the four heads of charity and whether it is for the public benefit.⁴⁴ The results of those cases often turn on subtle distinctions in the

⁴² *University of British Columbia v. British Columbia (Attorney General)*, 2000 BCSC 445.

⁴³ For information on meeting the “public benefit” test, see Canada Revenue Agency, “Policy Statement CPS-024: Guidelines for Registering a Charity: Meeting the Public Benefit Test” (March 10, 2006), online: <http://www.cra-arc.gc.ca/tx/chrts/plcy/cps/cps-024-eng.html>.

⁴⁴ See, for example, *Vancouver Regional FreeNet Assn. v. M.N.R.*, [1996] 3 F.C. 880 (F.C.A.).

wording of the restriction. One example that illustrates the significance of subtle distinctions in wording is the Diplock case⁴⁵ in which the court determined that while a trust for “charitable and benevolent” purposes is charitable, a trust for “charitable or benevolent” purposes is not. Accordingly, if the charity does not have an opportunity to provide input into the drafting of the restriction, it should ask legal counsel to confirm that the gift is exclusively charitable prior to accepting the gift.

Even if the gift is exclusively charitable at law, the charity must not accept a restriction on the use of the gifted property that is not within the objects of the charity. If the charity accepts a restricted gift that requires the charity to use the gifted property in a manner that is not contemplated by the charity’s objects, the directors or trustees of the charity can be personally liable for the actions of the charity in doing so.

Even if there are no legal impediments to accepting a restricted use gift, there may be practical reasons why the charity may want to decline the gift. A charity may not have the capacity to comply with restrictions that are incompatible with its mission. Alternatively, the administrative requirements of a restricted gift may consume an inordinate amount of the charity’s resources. In such circumstances, the charity would best serve its charitable objects by declining the gift. In this regard, it would be prudent for charities to adopt a policy that all restricted gifts need to be approved by the directors or trustees of the charity or by senior management where the board has delegated that authority. Charities should also avoid simplistic targets or quotas that encourage development staff to accept restricted gifts that are not in the best interests of the recipient charities.

c) Restricted Charitable Trust Property

Restricted charitable trust property is a term used to describe real estate that is gifted subject to certain terms of trust, usually contained in the deed to the property. Religious charities often receive or acquire property through deeds that set out specific terms of trust which may continue in perpetuity, even if the land and buildings are sold, by impressing the sale proceeds with the same terms of trust. As a result, it is essential that the board of a charity, particularly a religious charity, determine whether or not any of its real property, either now or in the past, is subject to

⁴⁵ *Ministry of Health v. Simpson*, [1951] A.C. 251 affirming *Re Diplock* [1948] Ch. 465.

restricted charitable purpose trusts and, if so, to ensure that the property either was, or is, currently being used in accordance with the applicable restrictions.

Generally, restrictions normally 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 that 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; and
- Restrictions limiting the use of the property to those who follow a particular religious practice, similar to requiring that the property be used only by members of a church who adhere to the practice of “strict communion” (where the sacrament of communion can only be received by baptized members of a particular denomination).

What is often not understood by a charity, either in receiving a deed to property from a vendor that is made subject to a special purpose trust or in unilaterally imposing a trust at the time that it takes title to the property, is that the trust that is created is generally a trust in perpetuity which will have permanent implications, similar to an endowment fund or to any other special purpose trust fund. Since the charity will not have the ability to unilaterally vary the terms of trust without court authorization, it needs to be both aware of the terms of trust and to ensure that it can either comply with the restrictions or otherwise seek court authorization to vary it.

Restricted charitable trust properties are almost invariably created by the inclusion of a specific trust clause in a deed or transfer of land. This can occur when a donor gifts property to a charity and intends the property to be used only for a particular purpose. In such a scenario, the donor may include a reversionary clause in the deed stipulating that the property is to revert back to the donor in the event that the terms of the trust are not complied with. When this occurs, it is important to review the specific wording in the deed to determine whether or not a condition subsequent has been created as opposed to a special purpose charitable trust since different legal implications flow from the distinction as is discussed below.

In the other usual scenario in which a trust clause is included in a deed, the charity itself imposes the terms of trust stating that the property being acquired can be used only for a specific purpose or purposes. The self-imposed terms of trust, though, would need to be consistent with the charitable objects of the charity. If not, it would be unlikely that the restricted charitable trust in the deed would be a valid and enforceable special purpose charitable trust.⁴⁶

d) Implied Special Purpose Charitable Trust Funds

The word “implied” in an implied special purpose charitable trust fund refers to what is required at law as evidence that the donor in fact intended to create a restricted charitable purpose trust. If the document accompanying a charitable gift clearly states that the gift is to be held in trust and the basic three certainties of a trust are met, the donor will clearly have created an express special purpose charitable trust. On the other hand, even if there is not express language, if the circumstances surrounding the gift or the general language in the document accompanying the gift are sufficient to establish that the donor intended the gift to be held in accordance with a special purpose charitable trust, then the donor would be considered to have established a special purpose charitable trust by implied intent.

Presuming that the reasoning of Levine J. in *Christian Brothers B.C.S.C.* prevails over that of Blair J. in *Christian Brothers Gen. Div.*,⁴⁷ instances where an implied special purpose charitable trust might be found would include the following:

- A public fundraising campaign initiated by the charity for a specific purpose, whether it be a capital endowment fund or a building project.⁴⁸
- A donor who gives money to a charity with no accompanying written documentation setting out his or her intentions. However, in discussions with the development officer for the charity and in preliminary correspondence between the donor and the development officer, there is clear reference made to the fact that the gift is to be held in perpetuity as

⁴⁶ For further discussion regarding how restricted charitable trust properties are created and a discussion of the applicable case law see Terrance S. Carter, *supra* note 1.

⁴⁷ See general discussion on special purpose charitable trusts, above at page 12.

⁴⁸ *Christian Brothers B.C.S.C.*, *supra* note 32 at para. 277.

an endowment fund for a particular purpose, such as funding a professorship at a university.

Most donors making a gift to a parallel foundation, such as a hospital foundation, assume that the gift will be used to benefit the parallel operating charity. However, some foundations have charitable objects that permit the board of the foundation to use the monies received by the foundation for purposes other than benefitting the parallel operating charity. Notwithstanding the doctrine of constructive notice,⁴⁹ (which states that third parties dealing with a corporation are deemed to have constructive notice of the registered public documents of the corporation), if the corporate authority of a foundation to give monies to charities other than the parallel operating charity has not been effectively communicated to its donors, particularly where the foundation has the same name as the parallel operating charity, and the public fundraising campaign makes reference to the need to support the parallel operating charity, donors who make gifts to the foundation could very well allege breach of an implied special purpose trust fund under section 6 or section 10 of the *Charities Accounting Act*⁵⁰ if the monies are disbursed to charities other than the parallel operating charity.

To overcome potential problems in this regard, it would be advisable for a foundation having objects allowing it to fund a broad spectrum of charities to ensure it has given donors clear written communication of this broad corporate authority – through brochures and annual reports, for example – to refute future allegations that an implied special purpose trust fund had been created by the foundation to benefit only the parallel operating charity.

Even though both the Ontario Court of Justice and the Ontario Court of Appeal in *Christian Brothers of Ireland in Canada (Re)*⁵¹ held that unrestricted charitable gifts are owned beneficially by a charitable corporation and are not held in trust for its charitable purposes, such property may still only be used in accordance with the corporate objects of the charitable corporation in compliance with the doctrine of *ultra vires* (pending its removal under the Canada *Not-for-profit Corporations Act*⁵² or the Ontario *Not-for-profit Corporations Act*⁵³) or in

⁴⁹ *Ernest v. Nicholls* (1857), 6 H.L. Cas. 401. See also Ontario Law Reform Commission, *supra* note 10 at 469.

⁵⁰ *Supra*, note 29.

⁵¹ *Christian Brothers C.A.*, *supra* note 31.

⁵² S.C. 2009, c.23.

⁵³ Bill 65, *Not-for-Profit Corporations Act*, 2nd Sess., 39th Parl., Ontario, 2010.

accordance with the general fiduciary obligation to apply charitable property to its corporate objects⁵⁴; otherwise, the board members of a charity could be found personally liable for losses which arose out of *ultra vires* actions they authorized. As such, there are similarities between an implied special purpose trust fund and an unrestricted gift to a charity. In both situations, there is an implied restriction on what the charity can do with the gift that has been received, with corresponding personal liability consequences to the board members if they fail to comply. With an implied special purpose charitable trust fund, the trust restrictions are gleaned from circumstantial evidence; with an unrestricted charitable gift, the restrictions are found in the charitable objects of the charity itself. In accordance with the doctrine of constructive notice, a donor is entitled to presume that the charitable objects of a charitable corporation are in fact those that are set out in its letters patent.

2. Precatory Trusts and Donor-Advised Funds

The basic characteristic of donor-advised funds and precatory trusts, in contrast to other forms of restricted charitable gifts, such as special purpose charitable trusts or conditional gifts, is that they do not have any legally enforceable restrictions associated with them. With both donor-advised funds and precatory trust funds, the donor expresses a preference, desire or request that something be done with the gift, but such expressions are made as a “suggested direction” rather than a legal obligation upon the charity. This notwithstanding, there are considerable practical consequences, and also significant moral obligations, placed upon a charity receiving such form of gift.

A precatory trust is actually not a trust at all, but only a nonbinding request of the donor.⁵⁵ Since a precatory trust is a misleading term in that it is not in fact a trust, it is more useful to describe such a gift as an unrestricted gift that is accompanied by a nonbinding designation. For ease of reference, such gifts may be referred to simply as “designated gifts.”⁵⁶ Designated gifts are often encountered by religious charities where donors wish to support a specific missionary who is employed by a missionary organization. In Interpretation Bulletin IT-110R3,⁵⁷ CRA permits a

⁵⁴ *Ontario (Public Guardian and Trustee) v. AIDS Society for Children (Ontario)*, [2001] O.J. No. 2170, [2001] O.T.C. 432, 39 E.T.R. (2d) 96, 105 A.C.W.S. (3d) 1044.

⁵⁵ *Christian Brothers C.A.*, *supra* note 31.

⁵⁶ This is not to be confused with the term of “designated gifts” referred to in the 2010 Federal Budget

⁵⁷ Canada Revenue Agency, “IT-110R3: Gifts and Official Donation Receipts” (June 20, 1997), online: http://www.cra-arc.gc.ca/E/pub/tp/it110r3/it110r3-e.html#P113_3712.

donor to make a gift subject to a general designation or direction, i.e., requiring that a gift be used in a particular program operated by the charity, provided that the decisions regarding the use of the donation within the program rest with the board of the charity. As a result, the designation by a donor that a gift is to be used to support missionaries in general would be acceptable to CRA, but the further designation that the gift *must* be used to support a particular missionary would not be acceptable to CRA, or binding on the charity. A donor could, however, indicate as a non-binding designation accompanying the gift that, where possible, the donation be used to support a particular missionary. Such a form of designation would constitute a designated gift or precatory trust because it would not be binding on the charity.

Distinguishing precatory wishes from binding trust obligations can be difficult. Clearly the use of phrases such as “in trust”, “on condition that”, or other mandatory language suggest the creation of a legally binding restriction. On the other hand, words such as “wish” or “desire” suggest that the donor did not intend to create a legal obligation. The difficulty arises when donors use less than clear or contradictory terminology. In such circumstances, a charity would be prudent to obtain a legal opinion in order to determine whether a trust has been created or not.

A donor-advised fund is a form of designated giving whereby the donor makes a gift to a charity and then periodically makes non-binding recommendations concerning the distribution of assets from the fund to other charities or for certain charitable activities. A donor-advised fund may allow the donor to make recommendations in one or two fashions. One possibility is that the charity may invite the donor to make recommendations on how the annual disbursements to be made by the charity are to be met. As well, some donor-advised funds may also invite donors to recommend how their original donation is to be invested by the charity.⁵⁸

Donor-advised funds are widely used in the United States where they are frequently referred to as “advise and consult funds”, “donor-designated funds”, “donor-directed funds”, “gift funds”, “advisory funds”, or simply “accounts” or “funds” within community trusts or foundations. The difference between a donor-advised fund and a designated gift or precatory trust is that with designated gifts, the donor’s intentions, although not binding, are stated only once at the time

⁵⁸ Susan Manwaring, “Donor Advised Funds: A Growing Option for Canadian Philanthropy” in *Charitable Thoughts* vol. 9, no. 2 (October 2005).

that the gift is made, whereas with donor-advised funds, the donor has input into the distribution of the funds on a continuing basis. In a sense, donor advised funds create more challenges for the charity than gifts subject to an initial precatory wish, because the charity has a moral obligation (though not a legal duty) to respond to the wishes of the donor on an on-going basis.⁵⁹

The primary concern with donor-advised funds is that if too much control is retained by the donor, it will no longer be considered a gift at law and cannot therefore be receipted under the ITA. As a result, charities that employ donor-advised funds must be careful to warn donors that input by the donor can be of an advisory nature only. All rights of ownership must be transferred by the donor to the registered charity, and the recipient charity must retain control over all its decisions, including investing and grant making. The documentation creating a donor-advised fund must clearly state that it is the charity that administers the fund, reserving the right not to follow the donor's suggestions or advice concerning its distribution or application.

The advantage of donor-advised funds is that such funds allow the donor to receive an immediate tax receipt for a charitable gift while deferring the ultimate disbursement of the gift for future charitable projects. It is similar to having an informal private foundation within the parameters of an established and well-organized charity that has the ability to provide proper administration and guidance from the charity's board of directors.

3. Conditional Gifts

The distinction between a conditional gift and a restricted charitable purpose trust is not an easy one to make, particularly since a conditional gift can also involve a charitable purpose trust. Part of the distinction relates to the ownership of the gift and the other part relates to the wording accompanying the gift. A conditional gift involves the charity becoming the beneficial owner of the gift, either after the condition has been fulfilled or until a condition subsequent fails or occurs, as the case may be. With a charitable purpose trust on the other hand, the charity never becomes the beneficial owner of the gift. Instead, the charity holds title to the gift in trust, subject to certain terms and restrictions. It is possible for a conditional gift to also be a restricted charitable purpose trust if the gift involves both a condition precedent and a donor requirement that the gift be used for a particular purpose. For example, the donor might say, "I give

⁵⁹ Terrance S. Carter, *supra* note 1 at 35-37.

\$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 2012.”

With a conditional gift, the operative wording involves a transfer of beneficial ownership of the gift, subject to an independent clause of defeasance commencing with words such as “but if”, “provided that”, or “on condition that.” It is not sufficient, however, to look only at a particular phrase or word to determine if a gift is conditional; it is important to look at the whole wording of the document by which the gift is given.⁶⁰

A condition which is repugnant to the nature of the gift granted, such as a condition that totally restrains the alienation of the gift by requiring, for instance, that rents of the property never be raised, will be void. Similarly, an illegal condition, such as a condition requiring a breach of the law or a discriminatory action, will also be void.⁶¹

The general rule that a charitable purpose is exempt from the rule against remoteness of vesting, i.e., the “modern rule against perpetuity”, does not apply to a conditional gift. The Ontario Law Reform Commission, Report on the Law of Charities⁶² stated that “In general, if a gift to a charity or charitable purpose trust is conditional, in unreformed jurisdictions, the rule applies to require that the gift necessarily vest within the perpetuity; in reformed jurisdictions [i.e., in Ontario], we ask whether it must so vest, and if not, we wait and see whether in fact it does so vest.”

Conditional gifts are either subject to a condition precedent or a condition subsequent. A condition precedent occurs when the condition must be fulfilled *before* the gift takes effect (for example, 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). In the event that a condition precedent fails, the transfer of the beneficial ownership of the gift to the charity will not occur and ownership of the gift remains with the donor. A gift subject to a condition precedent is not a gift at law until after the condition is fulfilled. Accordingly, it is improper for a charity to issue a receipt for tax purposes before the condition precedent is fulfilled.

⁶⁰ Hubert Picarda, *The Law and Practice Relating to Charities*, 3rd ed. (London: Butterworths, 1999) at 212.

⁶¹ Jean Warburton and Deborah Morris, *Tudor on Charities*, 8th ed. (London: Sweet & Maxwell, 1995) at 191.

⁶² *Supra*, note 10, at 408.

By contrast, a condition subsequent is a condition which operates to defeat a gift which has already been made (for example, a gift made to a charity on the condition that the funds be used to operate a particular named shelter for the homeless). If the condition subsequent fails and there is a right of reversion in the gift back to the donor, the reversion to the donor will only be operative if the failure of the condition occurred within the relevant perpetuity period and if the gift did not contain a gift over to another charity. If there is neither a reversionary right in favour of the donor nor a gift over, the failure of the condition subsequent will leave the initial interest of the charity as an absolute interest that is no longer subject to any conditions or other donor restrictions. Although a charity may issue a tax receipt for a gift subject to a condition subsequent, if the condition fails and the gift reverts back to the donor, the donor will receive a double benefit. In this regard, CRA advises that the charity returning the gift should inform CRA that the original gift is being returned to the donor so that CRA can ensure the returned gift is reported as taxable income by the donor.⁶³

Often, conditional gifts will be given subject to a “gift over” that will address the situation where the condition has not been met. This means that if the charity fails to comply with the condition, the gift will then transfer to another charity. If a gift over is valid, and the circumstances upon which it was to arise are shown to have happened, the property passes and cannot be recalled. It makes no difference that the gift over is for the benefit of another, different charity. However, lawyers who are instructed to provide for a gift over as part of a restricted charitable purpose trust should ensure that the gift over is to a charity with similar charitable purposes, since a gift over from a charity to a non-charitable purpose is void.⁶⁴

4. Determinable Gifts

A determinable gift is a technical variation on a gift that is subject to a condition subsequent. With a condition subsequent, the gift is absolute, but is subject to being defeated if the condition is not fulfilled. With a determinable gift, the gift consists of a limited interest which will eventually come to an end, such as “I give the income from my commercial building so long as I

⁶³ Canada Revenue Agency, “Summary Policy CSP-G04: Gift (Conditional)”, (September 3, 2003; revised November 23, 2005), online at: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/csp/csp-g04-eng.html>. For more information on conditions precedent and subsequent, see Jean Warburton and Deborah Morris, *supra*, note 61. at 143-150.

⁶⁴ *Supra*, note.61 at 146, 150.

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.⁶⁵ In this regard, a determinable gift “bears a seed of its own destruction and is said to determine automatically, whereas a conditional interest is complete but with an independent clause added which may operate to defeat it.”⁶⁶

When a determinable gift comes to an end, the capital will normally revert to the donor unless there is a gift over to another charity. As with a gift subject to a condition subsequent which is fulfilled, the charity should advise CRA of the taxable benefit to the donor where a determinable gift comes to an end and some or all of the original capital is returned to the donor.⁶⁷ Where there is a gift over, lawyers should ensure that the gift over is to another charity rather than a non-charitable entity. Otherwise, that portion of the gift will no longer qualify as charitable and the donor will not be entitled to claim any income tax credits or deductions with respect to the gift.

5. Gifts Subject to Donor Directions Under the *Charities Accounting Act*⁶⁸

In Ontario, donors also have the ability to enforce their restrictions via statute. Section 4(d) of Ontario’s *Charities Accounting Act* provides a mechanism by which the Public Guardian and Trustee can seek a court order requiring a charity to comply with the directions of a donor. If an executor or trustee “is not applying any property, fund or money in the manner directed by the will or instrument,” the Public Guardian and Trustee may apply to a judge of the Superior Court, and the judge, among other powers, has the power to enforce the direction of the donor.

The effect of section 4(d) of the *Charities Accounting Act* means that the Public Guardian and Trustee of Ontario can seek a court order to enforce a direction imposed by a donor without being required to establish that a restricted charitable purpose trust had been created. All that is required is that a “direction” by the donor be shown. This is a much lower threshold for either a disgruntled donor or the Public Guardian and Trustee of Ontario to meet, but still achieves the same result – as if a special purpose charitable trust had been created by the donor and had been

⁶⁵ *Ibid.* at 142.

⁶⁶ Picarda, *supra* note 60 at 278-279.

⁶⁷ *Supra* note 63

⁶⁸ *Charities Accounting Act*, *supra* note 29.

breached by the charity. In either situation, a court would be able to order the charity to comply with the terms of the direction established by the donor.

Ironically, if the violation was categorized by the courts as being a violation of section 4(d) of the *Charities Accounting Act*, then, in addition to the directors of a charity being found in breach of trust, the directors could also be exposed to a court imposed penalty and even face imprisonment in accordance with the provisions of section 4(k) of the *Charities Accounting Act*.

In addition, aggrieved donors in Ontario have additional rights under section 10(1) of the *Charities Accounting Act*. Where donors allege a breach of a trust created for a charitable purpose or seek the direction of the court for the administration of a trust for a charitable purpose, they can apply to the Superior Court of Justice for an order to carry out the trust subject to terms that the court considers just. The Public Guardian and Trustee must be given notice of an application under subsection 10(1).

*Ontario Society for the Prevention of Cruelty to Animals v. Toronto Humane Society*⁶⁹ is a recent example of where section 10 of the *Charities Accounting Act* was used to initiate a request for the instructions of the Court to enforce a charitable purpose trust based upon an alleged breach of trust. The Ontario Society for the Prevention of Cruelty to Animals (“OSPCA”), which has the ability to enforce standards of animal care throughout the province and to confer affiliate status on animal shelters in Ontario, suspended the Toronto Humane Society’s (“THS”) affiliate status after an investigation and launched a court application under section 10 of the *Charities Accounting Act*. The Court eventually approved a settlement agreement between the parties, but not without reaffirming the immense inherent power of the Court to ensure charitable purposes are being carried out by a charitable organization. In fact, the Court reserved the power to call the parties back before the Court to ensure that the charitable purpose was being carried out.⁷⁰

However, section 10 of the *Charities Accounting Act* is much broader than simply allowing aggrieved donors to use it to allege a breach of trust. Section 10 states that “Where any two or more persons allege a breach of a trust created for a charitable purpose *or seek the direction of*

⁶⁹ 2010 ONSC 608, 2010 ONSC 1953, and 2010 ONSC 2182.

⁷⁰ 2010 ONSC 2182.

the court for the administration of a trust for a charitable purpose, they may apply to the Superior Court of Justice and the court may hear the application and make such order as it considers just for the carrying out of the trust under the law” (emphasis added). Section 10 therefore encompasses two rights of action for aggrieved individuals. They are able to allege a 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 *Charities Accounting Act* is a powerful tool for donors or other interested parties who feel aggrieved and wish to obtain the Court’s assistance in enforcing a charitable purpose.⁷¹

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

Many donors and charities believe that the terms of a restricted charitable purpose trust can be varied at will. In fact, the objects of a restricted charitable purpose trust can only be altered by the court based upon the court’s inherent scheme-making power, unless the donor has provided the charity with the ability to vary the restriction in the trust document. As stated in *Tudor on Charities*:⁷²

[I]t is not for the trustees to deal with the funds on their own authority, even by the direction or approval of the original subscribers of the charitable funds or (where the trust is for the benefit of a particular parish or place) of a meeting of the parishioners or inhabitants.⁷³

This means that to vary a donor restricted charitable gift, assuming the gift does not include a power to vary, a court application would have to be made for a *cy-près* order, although with a straight forward application the charity may be able to proceed on the basis of a consent order from the Public Guardian and Trustee under section 13 of the *Charities Accounting Act*. In this regard, *cy-près* involves the ability of the Court to exercise its inherent jurisdiction to supply trust purposes (or objects) in place of those the donor or testator chose.⁷⁴ Prof. Waters indicates that “[t]o describe *cy-près* shortly, at the moment when the *inter vivos* or testamentary charitable

⁷¹ Additional cases where section 10 of the *Charities Accounting Act* was used include *O’Neill Community Ratepayers Assn. v. Oshawa (City)* (1995), 22 O.R. (3d) 648 (Ct. J. (Gen. Div.)) and *Rare Charitable Research Reserve v. Chaplin* (2006), 2006CarswellOnt 8774 (Ont. S.C.J.).

⁷² Jean Warburton and Debra Morris, *supra* note 61.

⁷³ *Ibid.* at 245-246.

⁷⁴ Prof. Donovan Waters, “Administrative and Cy-Près Judicial Scheme-Making: When are these Applications of Use in Canada Today?” (presented at the 2010 National Charity Law Symposium, April 30, 2010) online: <http://www.carters.ca/pub/article/charity/2010/waters0430.pdf> at 6.

trust would come into force, there is no way in which the declared purpose or purposes can be carried out, or during the lifetime of the trust there comes a time when the purposes of an endowment trust can no longer be carried out.”⁷⁵

The *cy-près* doctrine is generally stated as follows:

If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.⁷⁶

The *cy-près* jurisdiction of a court is only exercised when the charitable objects set out by the settlor are either impossible to carry out, or are impracticable. An example of what is meant by impossibility is a situation where the trustees are unable to use the fund for the particular purpose because the purpose has already been achieved, while an instance of impracticability is the erection of a church in an area where such a building is no longer necessary.⁷⁷

There are several Canadian cases in which the court has varied the terms of charitable purpose trusts. For instance, *Boy Scouts of Canada, Provincial Council of Newfoundland v. Doyle*⁷⁸ is a decision in which the court applied the *cy-près* doctrine to vary the purpose of a restricted charitable purpose trust where the original purpose could no longer be carried out. In that case the settlor of the trust had intended for a gifted piece of property to be used for the benefit of a particular Boy Scouts troop. The Newfoundland Court of Appeal decided that despite the fact that the troop had disbanded, rendering the purpose of the trust impossible to achieve, the trust could be expanded in accordance with the *cy-près* doctrine, to allow the property to be used for the benefit of all Boy Scouts groups now in existence.

Whether a court will be able to exercise a *cy-près* scheme will depend upon whether the failure is an initial failure or a subsequent failure. With an initial failure, but not a subsequent failure, the court will be able to intervene and apply the charitable property *cy-près* only if it can find a

⁷⁵ *Ibid.*

⁷⁶ American Law Institute, *supra* note 9 at para. 399.

⁷⁷ Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *supra* note 8 at 642.

⁷⁸ [1997] N.J. No. 151, 149 D.L.R. (4th) 22, 151 Nfld. & P.E.I.R. 91 (NLCA).

general charitable intention of the donor. This becomes particularly problematic in relation to public fundraising campaigns. If a surplus results from a public fundraising campaign for a particular charitable purpose, but the charity is unable to use the monies for its publicly stated purpose, the court can apply the remaining surplus to another charitable purpose only if it can find that the donors, many of whom may be anonymous, had a general charitable intention and did not limit their gifts to the specific project for which the fundraising campaign was directed. The primary problem involved with the surpluses resulting from public fundraising campaigns is therefore determining whether or not a general charitable intent can be found.

To avoid the complexities and costs of making 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 clearly state in its fundraising literature or on its website that any surpluses resulting from a public fundraising campaign for a particular project will be used to further the general charitable purposes of the charity in question.

Where there is a subsequent failure of a restricted charitable purpose trust, the court will apply the *cy-près* doctrine where it can be shown that there is a supervening impracticality or impossibility without finding a general charitable intent. This is, of course, subject to the requirement that the gift not contain a provision for a gift over by the donor.

In addition to the power to vary the objects of a charitable purpose trust with the *cy-près* doctrine, the court may also exercise its scheme-making power if adherence to the administrative terms of a trust would disrupt the specific purpose of the charitable trust. The normal situation where the court will permit deviation from administrative terms is where a change in circumstances makes adherence to the original administrative terms impossible or impractical.⁷⁹ For instance, see *Killam Estate v. Dalhousie University*⁸⁰ and *Toronto Aged Men's and Women's Homes v. Loyal True Blue and Orange Home*⁸¹ which provide examples where the court has varied the administrative provisions of charitable purpose trusts. In both cases, testamentary trusts had been established for charitable purposes and the trustees had been directed to maintain a capital fund in perpetuity with only the income to be used to fund charitable activities. In each

⁷⁹Prof. Donovan Waters, *supra* note 74 at 6-7. See also, Picarda, *supra* note 60 at 364-365..

⁸⁰(1999), 38 E.T.R. (2d) 50 (N.S. Sup. Ct.).

⁸¹(2003), 68 O.R. (3d) 777 (S.C.J.).

case, a court application was brought because the income generated by the trust's capital assets was insufficient to meet the charity's disbursement objectives. In both cases, the Court invoked its inherent jurisdiction to approve arrangements whereby the administrative provisions of charitable purpose trusts, which are perpetual in nature, are adapted to suit changing circumstances so as to accomplish the donor's charitable intent more effectively as economic times change. The Court accepted that its inherent jurisdiction allowed it to vary the terms of the trust to allow the charity to encroach on and distribute capital where the testator or settlor had directed the perpetual maintenance of a capital fund.⁸²

F. WHAT ARE THE *INCOME TAX ACT* ISSUES INVOLVED IN A RESTRICTED CHARITABLE PURPOSE TRUST?

1. Disbursement Quota Issues

Before drafting a restricted charitable purpose trust, it is also important to consider the potential income tax consequences that could result from the way in which the trust is drafted. Although recent proposed amendments to the *Income Tax Act* mean that charities no longer have to struggle with structuring long-term gifts or endowments to comply with complex *Income Tax Act* language related to "enduring property" or "10-year gifts", lawyers advising charitable clients or donors must still be cognizant of the income tax issues that could arise when drafting restricted charitable purpose trusts. This section of the paper focuses on the disbursement quota rules applicable to charities.

The *Income Tax Act* exempts registered charities from paying income tax. A charity is required to register regardless of whether it gives receipts to donors. However, if the charity provides receipts to donors, being a registered charity allows donors to claim tax credits if they are individuals or deductions if they are corporations from their own taxable income. A charity created by a single donor or group of donors who seek no tax credits or deductions from their own taxable income for their gifts, and which does not offer receipts for any subsequent gifts, must still be registered in order to obtain exemption from tax on its own income.⁸³

⁸² M. Elena Hoffstein, "Managing Endowments in Difficult Financial Times" (presented at the Canadian Association of Gift Planners, May 12-14, 2010).

⁸³ Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *supra* note 8 at 664-665.

Many of the income tax issues surrounding charitable purpose trusts relate to the disbursement quota (“DQ”). The DQ, which was introduced in 1976, was intended to ensure that a significant portion of a charity’s resources were to be devoted to charitable activities, as opposed to either fundraising or administrative costs.⁸⁴ The DQ rules were reformed in the 2004 Federal Budget, making the DQ even more difficult for charities to calculate. The details of those complexities are beyond the scope of this paper. Prior to the Federal Government’s 2010 Budget (“the 2010 Budget”), which was released on March 4, 2010⁸⁵ and followed by draft implementing legislation released on August 27, 2010⁸⁶, all registered charities were required to expend on their own charitable activities or on distribution to qualified donees an amount equal to 80 percent of the previous year’s tax-receipted donations (referred to as the “charitable expenditure rule” or the “80% DQ”) and 3.5 percent of the charity’s investment assets. There were exceptions, however, to the 80 percent charitable expenditure rule, which included enduring property, specified gifts (certain inter-charity transfers), and capital gains pools. Enduring property included endowments and long term gifts subject to 10 year holds, bequests, proceeds of life insurance, and RRSPs, RRIFs, and TFSA’s. Charities therefore had an incentive to structure gifts as enduring property to avoid the charitable expenditure rule. This meant that charities had to ensure that gift conditions were drafted, somewhat artificially, in such a manner as to meet the definition of “enduring property.” Resulting from this situation was a significant administrative burden placed on charities to either comply with the DQ or to structure gifts as enduring property.

However, the Federal Government’s 2010 Budget has resulted in proposed legislative changes that will eliminate the 80 percent DQ for registered charities and increase the exemption from the 3.5% disbursement quota. The Government recognized that over the years, the DQ had created an unnecessarily onerous administrative burden on registered charities that few charities and their staff had the ability to comply with, let alone understand. These burdensome complexities included having to wrestle with complicated concepts of enduring property, ten year gifts, capital gains pools and inter-charity transfers.

⁸⁴ Karen J. Cooper and Terrance S. Carter, “Significant Benefit for Charities in 2010 Federal Budget DQ Reform” in *Charity Law Bulletin* No. 197 (March 8, 2010), online: <http://www.carters.ca/pub/bulletin/charity/2010/chylb197.htm>.

⁸⁵ Department of Finance, *Budget 2010: Leading the Way on Jobs and Growth* (March 4, 2010), online: <http://www.budget.gc.ca/2010/>.

⁸⁶ Ministry of Finance, “Legislative Proposals Relating to the Income Tax Act, the Air Travellers Security Charge Act, the Excise Act, 2001 and the Excise Tax Act,” published by The Honourable Jim Flaherty, P.C., M.P. Minister of Finance (August, 2010), online: <http://www.fin.gc.ca/drleg-apl/ita-lir10l-eng.htm>.

Although the 80 percent DQ is now repealed, charities must still be cognizant of the 3.5% DQ. The 3.5% disbursement quota requires that the amount a charity spends each year on charitable activities (including gifts to qualified donees) be at least 3.5% of all assets not currently used in charitable programs or administration (commonly referred to as “investment assets”). The value of the assets in this regard is based on the average value of the charity’s assets that are not used directly in its charitable activities or administration in the 24 months immediately preceding the taxation year. This is also known as the “capital accumulation rule” or 3.5% DQ.

Prior to the enactment of Bill C-33 in 2005⁸⁷, only public and private foundations (but not charitable organizations) were subject to a disbursement quota on assets not used directly in charitable activities or administration. Bill C-33 not only reduced the 4.5% disbursement quota to 3.5%, but also amended the *Income Tax Act* by expanding the application of the reduced 3.5% DQ to charitable organizations. For charitable organizations registered after March 22, 2004, the 3.5% disbursement quota applies to their taxation years that begin after March 22, 2004. For charitable organizations registered before March 23, 2004, the 3.5% disbursement quota applies to their taxation years that begin on or after January 1, 2009.⁸⁸

The reduced 3.5% DQ applied to all registered charities (including charitable organizations, public foundations, and private foundations) only if the amount of the charity’s investment assets was greater than \$25,000. However, with the 2010 Budget, the existing \$25,000 threshold for the 3.5% DQ is increased to \$100,000 for charitable organizations. This helps to reduce the compliance burden on small charitable organizations, and provides them with greater ability to maintain reserves to deal with contingencies. The threshold for both public and private charitable foundations, however, remains at \$25,000.

The 2010 Budget has therefore simplified the application of the *Income Tax Act* for charities. A number of often-confusing concepts have been eliminated, including the following:

⁸⁷ *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004 (Budget Implementation Act, 2004, No. 2)*, S.C. 2005, c. 19.

⁸⁸ The detailed method for the calculation of the 3.5% DQ is set out in ss. 3700, 3701, and 3702 of the *Income Tax Regulations*, C.R.C. 1978, c. 945 (am. SOR/87-632, s. 1; SOR/94-686, ss. 22(f), 51(F), 73(F), 79(F)). Also see Theresa L.M. Man, “Calculation of 3.5% Disbursement Quota for All Registered Charities” in *Charity Law Bulletin* No. 150 (December 18, 2008), online: <http://www.carters.ca/pub/bulletin/charity/2008/chylb150.htm>.

- Enduring property (gifts to a charity for endowments or multi-year charitable projects which are not subject to the charitable expenditure rule);
- The capital gains reduction and capital gains pool (provisions that ensure that capital gains realized from the disposition of enduring property are not subject to the charitable expenditure rule and the capital accumulation rule);
- Specified gifts (a provision that allows charities with disbursement excesses to help charities with disbursement shortfalls to meet their disbursement quota requirements); and
- Exclusions from the calculation of the base to which the 3.5% disbursement rate is applied (provisions to ensure that funds subject to the charitable expenditure rule are also not subject to the capital accumulation rule).

Additionally, the 2010 Budget proposes an amendment under which CRA will be given the discretion to exclude the accumulated property from the capital accumulation rule calculation (the 3.5% DQ).

The repeal of the charitable expenditure rule (or the 80% DQ) and increase to the threshold for the application of the 3.5% capital accumulation rule for charitable organizations is a significant improvement for charities, decreasing substantially the administrative complexity of complying with the DQ, particularly for small and rural charities. Charities will no longer have to struggle with structuring long-term gifts or endowment funds to comply with complex *Income Tax Act* language related to enduring property. Instead, charities will now be able to focus their efforts on balancing donor desires for long-term financial stability with the need for flexibility to meet changing economic conditions. Charities and their lawyers will not have to spend scarce resources accounting for and allocating expenses between those related to carrying on charitable activities and overhead or administrative expenses. The focus will now be on complying with

CRA's Guidance with respect to fundraising expenditures⁸⁹ to ensure that excessive fundraising costs are avoided.⁹⁰

The practical impact of the 2010 Budget reform of the DQ is that charities and donors will no longer have to contend with the artificiality of the 10-year gift provisions when structuring new long term gifts, including perpetual endowments. Charities should note, however, that while the 80% DQ may have been removed, along with the 10-year-gift requirements, the provisions of a trust may still require the charity to abide by 10-year restrictions on expenditure, as a matter of trust law, even though the need to comply with the *ITA* no longer applies. As such, where a gift has been established as a 10-year-gift, notwithstanding the repeal of the 80% DQ and related concept of "enduring funds", such reform does not grant a charity the discretion to access the funds, as such action would be in violation of the terms of the original trust.

2. Anti-Avoidance Provisions

Lawyers drafting restricted charitable purpose trusts also need to be aware of anti-avoidance provisions included in the 2010 Budget. The stated purposes of the anti-avoidance provisions are to ensure that charities do not enter into transactions which are meant to avoid or unduly delay the expenditure of amounts on charitable activities in accordance with the DQ requirements, as well as to ensure that inter-charity transfers between non-arms length charities will be used to satisfy the DQ of only one charity.

In this regard, amended par.149.1(4.1)(a)⁹¹ provides that a registered charity may not enter into a transaction (including a gift to another registered charity) where it may reasonably be considered that a purpose of the transaction was to avoid or unduly delay the expenditure of amounts on charitable activities in accordance with the DQ, failing which the charity may be subject to revocation of its charitable status and/or a penalty of 110% of the amount of expenditure avoided

⁸⁹ Canada Revenue Agency, "Policy Statement CPS-028, Guidance on Fundraising by Registered Charities" (June 11, 2009), online: <http://www.cra-arc.gc.ca/tx/chrts/plcy/cps/cps-028-eng.html>. See also Canada Revenue Agency, "Additional Information on Guidance CPS-028, Fundraising by Registered Charities" (June 11, 2009), online: <http://www.cra-arc.gc.ca/tx/chrts/plcy/cps/cps-028-ddn-eng.html>.

⁹⁰ For a more detailed discussion of changes resulting from the 2010 Budget, see Karen J. Cooper and Terrance S. Carter, *supra* note 84.

⁹¹ *Supra*, note 86.

or delayed. Where the transaction was one in which both parties were registered charities, both charities are jointly and severally, or “solidarily”, liable for the penalty.

As well, amended par.149.1(4.1)(d)⁹² provides that in the event of a transfer between non-arm’s length charities, the fair market value of the property transferred must be expended by the recipient charity in the year of the gift or in the following year, failing which the charity may be subject to revocation of its charitable status and/or a penalty of 110% of any unexpended portion of the fair market value of the property. As an alternative, the transferor charity will be able to elect that the property transferred will not count toward satisfying its DQ by reporting it as a “designated gift”, in which case the recipient charity would not be subject to the immediate disbursement requirement under the anti-avoidance provision.

On its face, the scope of the new anti-avoidance provisions is quite broad, particularly since it is unclear what “transaction” or “arms-length charity” will mean in practice. Charities and their legal counsel will therefore need to be cautious pending further clarification from CRA regarding the application of these provisions.

G. WHAT PROVISIONS SHOULD BE CONSIDERED WHEN DRAFTING RESTRICTED CHARITABLE PURPOSE TRUSTS?

It is important to remember that 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, lawyers must carefully consider what provisions to include when drafting testamentary and *inter vivos* restricted charitable purpose trusts, taking into consideration the need to ensure both the validity of the trust, as well as the legal and moral implications of the trust. This section of the paper will highlight some of the more important issues that lawyers should consider when drafting the specific terms of restricted charitable purpose trusts.⁹³

⁹² *Ibid.*

⁹³ See Terrance S. Carter, “Effectively Structuring Endowment Agreements” (October 1, 2009), online: http://www.carters.ca/pub/seminar/charity/2009/tsc1001_files/frame.htm.

1. Initial Considerations Involving Endowment Funds

Frequently, lawyers will be asked by their clients to draft of an endowment in some form. However, the client, whether it be a donor or a charity, will often not be sure what they mean in requesting an endowment. Lawyers therefore, need to be careful before using the term endowment when drafting restricted charitable purpose trusts. The fact is that “endowment” is not a *legal* word.⁹⁴ Rather, it is a term of art that is most often used by charities and donors to indicate an intention that the capital of a restricted purpose charitable trust fund is to be held “in perpetuity.” However, the word “endowment” has also been used in recent years to refer to trusts where the capital is to be retained for a minimum period of 10 years in the form of a 10 year gift pursuant to the DQ rules that were in existence prior to the 2010 Budget reform rather than requiring that the capital of the trust be held in perpetuity. Usage of the term “endowment” in this context, i.e. of establishing 10 year gifts, has caused significant confusion with donors to date.

As a result, the words that are used in establishing a restricted charitable purpose trust need to carefully reflect what the donor actually wants and what the charity is prepared to accept. Specifically, donors and charities should only use the term “endowment” where it is intended that the capital is actually to be held in perpetuity, in which event the restricted charitable purpose trust should be called a “perpetual endowment” to be absolutely clear regarding what is intended. With gifts where the capital is to be held for some specific period of time, but not in perpetuity, those gifts should be called “long term funds” or by some similar terminology, as opposed to a “perpetual endowment.”

In this regard, it is important to recognize that not every charity actually wants to receive a perpetual endowment because of the difficulty in administering those funds into the future and the concern that circumstances in the future may require that the capital of such funds be expended. Even when a charity is prepared to accept a perpetual endowment, the charity will normally only be interested in receiving such type of gift if there is the inclusion of a provision giving the charity the ability to encroach on the capital under certain special circumstances, such as meeting the DQ, or in response to extenuating circumstances as may be determined by the board of the charity from time to time. This last point is an important consideration that legal

⁹⁴ See Malcolm D. Burrows, “The End of Endowments?” (2010) vol. 23, no. 1 *The Philanthropist* at 54.

counsel should carefully discuss with the charity or donor before drafting a restricted charitable purpose trust that is intended to create a perpetual endowment in order to ensure that the charity and the donor both fully understand the difference between a perpetual endowment with no ability to encroach, a perpetual endowment with the ability to encroach, and a long term fund where the capital of the fund will be expended by a particular date.

2. Thresholds in Establishing a Restricted Charitable Purpose Trust

The charity should consider whether it will require a minimum amount in order to accept a restricted charitable purpose trust. For example, if a donor would like to create a restricted charitable purpose trust with a gift of \$5000.00, the charity should consider the cost to the charity that will be spent in administering that trust. As well, the charity will want to consider whether further contributions of capital to the restricted charitable purpose trust will be permitted, and if so, whether there should be any limitations imposed on these further contributions, such as who may make contributions and whether a minimum donation will be required. Prior to the 2010 Budget changes discussed above, charities would have had to structure additional contributions to the capital of long-term charitable purpose trust funds as separate 10-year gifts in order to comply with the enduring property exemption requirements in the *Income Tax Act*, which resulted in significant administrative burdens for the charity. However, with the repeal of the 80% disbursement quota and 10-year gift requirements for enduring property, charities are now able to structure restricted charitable purpose trusts to receive additional capital contributions on an ongoing basis.

3. Description of Restricted Purpose

The donor and the charity must ask what the restricted purpose of the charitable purpose trust is, and whether such restricted purpose is to be permanent, or whether variations to the restricted purpose should be permitted. If the restricted purpose is intended to be permanent, it must be sufficiently general in order to meet the test of time and changing circumstances. However, the charity must consider what will happen to the restricted charitable purpose trust when the intended restricted purpose has been achieved, is no longer relevant, or is no longer practical. As a result, it is generally advisable to include a provision permitting the charity to vary the restricted purpose in the discretion of the board of the charity in order to avoid having to seek a

cy pres order from a court to do so.⁹⁵ Variation of the restricted purpose of the trust is discussed in more detail below.

With regards to the specifics of the restricted purpose, as explained earlier in this paper, it is possible to include restrictions dealing with time, such as a restriction to hold the gift over a number of years, or in perpetuity (normally subject to some type of right to encroachment), or a restriction on use, such as a scholarship, or combination restriction (i.e. a perpetual endowment with the income to be used for medical research). Determining which restrictions are appropriate and how broadly or narrowly to word these restrictions will require careful drafting, often involving consultation with both the charity and the donor where possible.

4. Assets Forming the Trust

The charity must consider what assets the restricted charitable purpose trust will consist of. For instance, will the trust consist of monies or gifts in kind, such as shares? Different types of property will have to be handled differently by the charity. For example, if the trust involves a gift of shares, the charity needs to ensure that there is a proper evaluation of the shares done in advance of the gift. Gifts of publicly traded shares will be exempt from capital gains tax, but not gifts of private shares.⁹⁶ As well, whether the gift consists of cash or a gift in kind such as shares, it is important for both the donor and the charity to give consideration to whether the split receipting and anti-tax shelter provisions of the *ITA* could affect the fair market value of the gift for receipting purposes, either through the deduction of an “advantage” from the fair market value of the gift, or the reduction of the fair market value of the gift through the deeming provision applicable to some specific types of gifts in kind.⁹⁷

⁹⁵ Elizabeth Moxham, “Endowments 2.0: Rethinking Endowments in the New World” in *Gift Planning in Canada* vol. 15, no. 5 (May 2010).

⁹⁶ *Income Tax Act*, *supra* note 4, s.38 (a.1). For more detail see Terrance S. Carter, “An Overview of Capital Gains Tax Exemptions as a Philanthropic Incentive in Canada” (presented for the Australian Centre for Philanthropic and Nonprofit Studies *Modernising Charity Law Conference*, Brisbane, 2009).

⁹⁷ For more information on the application of the split-receipting rules and anti-tax shelter provision of the *ITA* see M. Elena Hoffstein and Theresa L.M. Man, “When Is an Advantage Not an Advantage--Issues Arising From the Proposed Split Receipting Regime” (presented for the Canadian Bar Association and the Ontario Bar Association *4th National Symposium on Charity Law*, Toronto, May 2006); and also Theresa L.M. Man, “Recent *Income Tax Act* Amendments That Affect Charities” *Charity Law Bulletin No. 221* (July 29, 2010), online: <http://www.carters.ca/pub/bulletin/charity/2010/chylb221.pdf>.

5. Naming Rights

Some donors may wish to build naming rights into the terms of the trust. If so, the charity must determine how long the naming rights will extend for. A Charity must also decide whether it wishes to reserve the right to terminate the naming rights of a donor, and under what circumstances it can do so.

Both the donor and the charity may also need to consider whether the naming rights might be considered to constitute a taxable “advantage” under the *ITA*. The position of CRA is that individual naming rights on their own do not constitute an advantage that would prejudice the ability of the donor to obtain a tax receipt for the full value of the gift.⁹⁸ However, for a business, if the naming rights amounted to a form of sponsorship which promoted the brand or the products of the business, then the naming rights could very well constitute an advantage that would need to be deducted from the fair market value of the gift. However, the business would then be able to deduct the value of such advantage as a business expense and would be in the same tax situation as if the full amount of the gift was received.⁹⁹

6. Disbursing Trust Funds

One of the most difficult issues to deal with in drafting a restricted charitable purpose trust is to determine on what basis trust funds are to be disbursed in accordance with the terms of the restricted charitable purpose. If there is no restriction as to time, then the charity will generally disburse funds received together with any short-term 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 is to be expended on the restricted purpose, or if only a portion is to be expended with the balance being capitalized, presumably in order to keep up with inflation.

Another issue that may need to be addressed is whether the income to be disbursed is to include interest and dividend income only or whether it is also to include realised capital gains. In this regard, the charity might want to consider utilising a total return investment model where the

⁹⁸ Canada Revenue Agency, *supra* note 57.

⁹⁹Theresa L.M. Man, “Corporate Giving: A Tax Perspective” (April, 2007) online: http://www.carters.ca/pub/article/charity/2007/tlm_corpgiving.pdf.

charity is directed to treat all returns from the fund as expendable on an annual basis, whether derived from interest, dividends, or capital gains.¹⁰⁰

Whatever preference a charity has toward these issues, it is generally better to have the charity clearly articulate them in its own disbursement policy that it can then amend from time to time and have the terms of that disbursement policy then incorporated by reference into the trust document instead of leaving it to be worked out within the terms of the trust document itself or leaving it up to the direction of the donor.

7. Donor-Advised Provision

Another consideration is whether the donor wishes to retain some input into the disbursement of the trust funds as a “donor advised fund.” As discussed earlier in this paper, in such cases, the donor will retain the ability to provide non-binding advice with regards to how the capital and income of the gift will be used. However, it should be made clear to the donor that the board of the charity must ultimately exercise its discretion over the expenditure of the income and capital of the gift. As indicated previously, too much control by the donor will defeat the gift and will result 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 CRA.

8. Administration Fee

Another issue to consider in drafting a restricted charitable purpose trust is whether the charity wishes to be allowed to charge a reasonable administrative charge against income and/or capital of the trust fund. If so, the charity should either reflect the details of the administrative charge in the trust document itself, or the charity should require a cross-reference in the trust document to the gift acceptance policy of the charity that would set out a reasonable administrative fee that would be charged against the income and/or capital of the trust funds.

9. Investing Trust Monies

When drafting a restricted charitable purpose trust, lawyers should become familiar with the investment policy of the charity (if there is one), since such policy will normally determine how

¹⁰⁰ Malcolm D. Burrows, *supra* note 94 at 54, 58. See also *Killam Estate*, *supra* note 80 and *Toronto Aged Men’s and Women’s Homes et al.*, *supra* note 81.

the capital of the restricted purpose charitable trust will be invested. In Ontario, the *Trustee Act* requires that there be an investment policy if investment decision making is delegated.¹⁰¹ Although it is not a requirement that there be an investment policy where there is no delegation of investment decision making, it is still advisable for a charity to consider adopting an investment policy. A well drafted investment policy will help protect the board of directors from personal liability, and it will also assist in ensuring that the board of directors has addressed the statutory requirements in the *Trustee Act* (Ontario).¹⁰²

The standard of care by which trustees, including charities with regards to charitable property, must adhere to when investing trust monies has been implemented by statute in every Canadian jurisdiction.¹⁰³ 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.”¹⁰⁴ This means that trustees are free to invest in any form of property they wish, so long as it is one in which a prudent investor would invest. A trustee’s investment decisions will be viewed objectively to determine if the standard is met. If an investment were to perform poorly, or lose money, the trustee would not be liable for the loss if he or she is able to demonstrate that the investment was made according to a reasonable assessment of risk and return that a prudent investor would make under similar circumstances.¹⁰⁵ Charities will generally want to incorporate by reference their investment policies into the trust document, or alternatively the charity might be prepared to allow the donor to impose specific investment terms of reference on the gift, although the former is preferable. Where the donor does impose specific investment terms the charity will need to ensure that they are consistent with the “prudent investor” standard set out in the *Trustee Act*, its existing investment policy, as well as its charitable purposes, before accepting.

¹⁰¹ *Trustee Act*, R.S.O. 1990, c. T.23, s. 27.1(2).

¹⁰² For more information see Terrance S. Carter, “Considerations in Drafting Investment Policies in Ontario” in *Charity Law Bulletin* No. 207 (April 29, 2010), online at: <http://www.carters.ca/pub/bulletin/charity/2010/chylb207.htm>.

¹⁰³ Terrance S. Carter, “Investment Powers of Charities and Not-for-Profits Under Ontario’s *Trustee Act*” in *Charity Law Bulletin* No. 192 (February 25, 2010), online at: <http://www.carters.ca/pub/bulletin/charity/2010/chylb192.htm>.

¹⁰⁴ *Supra* note 101, s. 27(1).

¹⁰⁵ *Supra* note 103.

10. Variation of the Trust

At the outset, it is important to remember that the donor cannot vary the terms of the charitable trust after it has been created, although as stated above, the donor can retain the ability to provide non-binding input through a donor-advised provision as part of the terms of the trust. As well, as stated earlier in this paper, the charity has no authority to vary the terms of a charitable trust on its own unless the document creating the restricted charitable purpose trust permits the charity to modify the terms of the trust. As such, it is essential that the trust document include a provision that permits the charity to vary the terms of the restricted purpose at the discretion of the charity, whether such restriction deals with restrictions involving use or time. The lawyer needs to ensure that the charity is given the maximum amount of flexibility in this regard as possible.

11. Transfer of Trust Property

Another important provision to consider including in the trust document is one that provides the charity with the ability to transfer the trust funds to a subsequent trustee, provided that the subsequent trustee is a registered charity and will enter 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 pursuant to section 3 of the *Trustee Act*. If the recipient charity is not at arms length to the transferor charity, then the transferor charity will want to record the transfer as a “designated gift” in its T3010B in order to avoid the recipient charity being required to spend 100% of the transferred property by the end of the following taxation year in accordance with the proposed new anti-avoidance provisions referred to above.

12. Return of the Gift

A charity, when accepting a gift by means of a restricted charitable purpose trust, may want to consider whether it should expressly reserve the right to refuse or even return the gift. If it wishes to reserve this right, it will need to consider under what circumstances it will do so. Some examples are where the donor has been criminally convicted, has exhibited immoral conduct, or the charity has concerns about the donor being involved in terrorist activity.

Where the charity is in a situation where the return of a gift is necessary, the charity will first need to correct the previously issued charitable receipt. In this regard, the charity would need to issue a replacement receipt which would be for “nil” or the reduced value of the gift. It would also need to file adjustments to the charity’s T3010B Information Return for the affected year, thereby reducing the amount of receipted donations listed on line 4500 of the return. Such adjustments would be filed using Form T1240 *Registered Charity Adjustment Request*.¹⁰⁶ The charity also needs to inform CRA when it returns a gift with a letter disclosing the refund, the reason for the refund, and attaching a replacement receipt.¹⁰⁷

13. Anti-Terrorism Considerations

As well, charities may also need to consider addressing due diligence considerations under Canada’s broad reaching anti-terrorism legislation. The terms of that legislation can significantly impact charities, particularly those charities operating outside of Canada in conflict zones. Accordingly, the charity may need to take appropriate steps to ensure that it conducts the necessary due diligence inquiries of the donor.¹⁰⁸ The charity may also want to consider retaining a discretion in the trust document *not* to apply the trust monies to the restricted purpose in the event of anti-terrorism concerns as determined in the discretion of the charity.

14. Independent Professional Advice

Finally, before accepting a gift that is subject to a restricted charitable purpose trust, 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 to have it confirmed in the trust document. Doing so will help reduce the risk of a gift subsequently being challenged by the family of the donor due to allegations of undue influence. In this regard, the charity should be aware of any other evidence of undue influence apparent in the donor’s actions, and should appropriately address any concerns about undue influence before the gift has been made.

¹⁰⁶ Kate Lazier and Andrew Valentine, “Considerations Involved with the Return of a Gift” (presented at the 2010 National Charity Law Symposium, April 30, 2010).

¹⁰⁷ While there is no statutory requirement to report refunded donations to CRA, CRA has taken the administrative position that it expects to be informed where a charity returns a gift. See Canada Revenue Agency, *supra* note 63.

¹⁰⁸ For more information see www.antiterrorism.ca See also Terrance S. Carter, Sean S. Carter, and Nancy E. Claridge, “The Impact of Anti-Terrorism Legislation on Charities in Canada: The Need for an Appropriate Balance” (October 26, 2007), online at: <http://www.carters.ca/pub/article/charity/2007/tsc1026.pdf>.

15. Considerations When Drafting Board-Created Restricted Charitable Purpose Trusts

When considering what terms to include in a board-created restricted charitable purpose trust to which donors would be invited to make contributions, the substantive terms of the trust should generally be similar to the terms of a donor-created trust as described above, and therefore should be as carefully drafted as the terms of a testamentary or *inter vivos* charitable trust.

Additionally, boards should be careful to ensure that they adopt a board resolution to authorize the restricted charitable purpose trust when establishing the terms of the fund. In fact, there should be a board resolution to authorize each separate board-created trust or alternatively, there should be a board resolution to delegate that ability to an authorized officer of the charity. Lastly, to reduce the risk that the restricted charitable purpose trust will be challenged, the board should take steps to ensure that the terms of the trust have been adequately communicated to the donor in writing.

H. BASIC MANAGEMENT CONSIDERATIONS OF RESTRICTED CHARITABLE PURPOSE TRUSTS

Charities that have established restricted charitable purpose trusts still have work to do in managing those trusts and it is therefore important for lawyers who draft those trusts to be aware what the responsibilities are and what restrictions may apply.

1. Initial Review of the Trust Document

Whenever a gift is identified as a restricted charitable purpose trust, whether as a testamentary or an *inter vivos* trust, it is important that the management of the charity carefully review the terms of the donor-restrictions to ensure that several crucial elements are addressed. First, the charity must ensure that the restrictions placed on the gift are actually charitable. This is because restrictions that are not charitable in nature will render the entire restricted charitable purpose trust invalid. All non-charitable purpose trusts are invalid because a purpose, other than a charitable purpose, cannot enforce a trust.¹⁰⁹ Even after determining that the restrictions on the trust are charitable in nature, the charity must ensure that the restrictions are within the charitable

¹⁰⁹ Donovan W. M. Waters, Mark R. Gillen, and Lionel D. Smith, *supra* note 8 at 626.

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.

If the restrictions are both charitable in nature and are within the charitable purposes of the charity, the charity must determine whether the restrictions are possible and practicable. It is pointless to have a restricted charitable purpose trust with restrictions that make the trust impossible or impractical to administer. It is therefore important that the charity make this determination at the outset so it can avoid wasting valuable time and money on managing an unworkable charitable trust.

Lastly, if all these questions have been answered affirmatively, the charity must then determine whether the restrictions are, in fact, acceptable to the charity. If any of these questions are answered in the negative, then the charity should not accept the gift. Instead, the gift should be returned to the donor and no charitable tax receipt should be issued. Alternatively, if the gift is subject to restrictions that the charity wishes to accept but such restrictions are either impossible or impractical, then the charity would need to apply to a court to have the court exercise its *cy-près* scheme-making power to vary the terms of the restricted trust “as near as possible” to the original restrictions imposed by the donor.

Once a decision is made to accept a restricted charitable purpose trust, then the charity and its administration must be careful to ensure that the funds in question are in fact managed as charitable trust funds. Appropriate management in this regard would involve consideration of some of the steps described next.

2. Banking Considerations

Since a restricted charitable purpose trust is, by its very nature, given to a specific charity, the gift must be deposited into the bank account of that charity. This is often a problem with charities that have parallel foundations, like hospitals where the gift to the hospital is directly deposited into the bank account of the parallel foundation.

As well, when depositing the gift into its bank account, the charity must consider the limitations involved in commingling restricted purpose charitable trusts. At common law, gifts subject to

restrictions should be held in separate accounts from other restricted trust funds and not commingled. However, a Regulation under Ontario's *Charities Accounting Act* now permits commingling of restricted charitable purpose trust funds if certain requirements are met.¹¹⁰ 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. Regardless, a charity still cannot commingle restricted purpose charitable trust funds with its 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.¹¹¹

Furthermore, the charity must ensure that it never borrows against restricted charitable purpose trust 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.

3. Investing Trust Monies

Where a charity needs to invest restricted charitable purpose trust funds, the fund must be invested in accordance with the specific investment powers set out in the document creating the restricted charitable purpose trust or, if there is no special investment clause in the trust document, then in accordance with the general investment powers of the charity. If the charity has an investment policy, the charity will be governed by its terms. If the charity does not have an investment policy, the charity will have to abide by the legislation in the applicable provincial jurisdiction. In Ontario, the governing legislation is the *Trustee Act*.

¹¹⁰ *Approved Acts of Executors and Trustees*, O. Reg. 4/01, s. 3.

¹¹¹ Terrance S. Carter, "The Effect of New Regulations under the *Charities Accounting Act*" in *Charity Law Bulletin* No. 4 (April 12, 2001), online at: <http://www.carters.ca/pub/bulletin/charity/2001/chylb04-01.pdf>.

In this regard, the *Trustee Act* applies to all charities that deal with charitable property in the Province of Ontario, whether organized as corporations, charitable trusts, or unincorporated charitable associations. One exception to this rule is section 27(9) of the *Trustee Act*, which states that the investment powers in the *Trustee Act* “do not authorize or require a trustee to act in a manner that is inconsistent with the terms of the trust.” The *Trustee Act* further provides that the constating documents of a charitable corporation under the *Charities Accounting Act* are deemed to form part of the terms of the trust.¹¹² This means that if the letters patent of the corporation contain different investment powers from those under the *Trustee Act*, the investment powers of the letters patent will take precedence, regardless of whether the charitable corporation is incorporated in Ontario, federally, or in another province.

In Ontario, where the power to invest funds is not set out in the document creating the charity, or where the document states that the charity must invest funds in accordance with the applicable provincial legislation, the charity must comply with the requirements of the *Trustee Act*. However, confusion may arise where various funds are being held by the charity and different investment powers apply to one or more of those funds. Charities operating in Ontario should therefore keep in mind these general guidelines:

- If the letters patent or legislation incorporating a charity is silent on investment powers, the *Trustee Act* (Ontario) applies.
- If the letters patent or legislation incorporating a charity establishes specific investment powers for the charity, those powers will take precedence over the provisions of the *Trustee Act*.
- Where funds are received by a charity through a restricted charitable purpose trust (whether testamentary or *inter vivos*) that has specific investment powers, those investment powers will take precedence over the general investment powers of the charity.

¹¹² *Trustee Act*, *supra* note 101 s. 27(10).

- If a charity receives a transfer of restricted trust funds from another charity, the investment powers of the transferring charity would most likely constitute the investment parameters for the funds being received by the recipient charity.

It is therefore important that a charity, its board of directors, and its management become cognizant of the various investment powers that may apply and then ensure that the terms of such investment powers are complied with in relation to the funds in question. Failing to do this could expose the directors of the charity to potential liability for breach of trust.¹¹³

As well, public fundraising appeals for a specific program, such as monies required for a building program, should contain a clear statement that any surplus monies remaining after the necessary funds have been raised for the designated project or program will be used to further the general charitable purposes of the charity. This would avoid the charity having to make a *cy-près* application in order for the court to exercise its scheme-making authority.

4. Protection of Restricted Charitable Purpose Trusts

The management of restricted charitable purpose trusts also requires consideration concerning what steps can be taken to protect such trust funds when they are created. In this regard, the decision of the Ontario Court of Appeal in *Christian Brothers Gen. Div.* has resulted in increased vulnerability for restricted charitable purpose trust funds.

The Christian Brothers decision concerned the Christian Brothers, a worldwide Roman Catholic teaching order that operated a number of schools and orphanages throughout Canada. The Christian Brothers were found guilty of criminal charges and were held liable for civil damages relating to sexual, physical, and emotional abuse that had been carried out by its members at the Mount Cashel School, a facility owned and operated by the Christian Brothers in St. John's, Newfoundland. The claims for damages against the Christian Brothers far exceeded their general corporate assets and totalled an estimated \$67 million.

Being incapable of fulfilling these claims, the Christian Brothers made application to be wound up, and the liquidator asked the court for advice and direction on legal questions relating to

¹¹³ For more information on the investment powers of charities in Ontario, see Terrance S. Carter, *supra* note 103.

whether certain charitable assets could be used to satisfy tort claims. Specifically at issue was the question of whether two of the Christian Brother schools (which were located in B.C.) were assets that could satisfy these claims. The schools had been established by the Christian Brothers through donations and were purportedly held in trust by them for the purpose of Catholic education. The Ontario Court of Appeal held that all assets of a charity, whether they are owned beneficially by a charity or they are held by the charity pursuant to a restricted charitable purpose trust, are available to satisfy claims by tort victims upon the winding-up of the charity – even if the basis for the claims has no relationship to the property in question.

The Ontario Court of Appeal’s decision means that no longer are restricted charitable purpose trusts recognized as separate trusts distinct from the general assets of the charity for exigibility purposes.¹¹⁴ In this regard, it is important for lawyers advising charities and donors to discuss with their clients what steps can be taken to assist in protecting those trusts at the time of their creation. This would generally involve having the restricted charitable purpose trust held outside of the charity itself, subject of course to applicable insolvency legislation. Options in this regard include utilizing an arms-length parallel foundation or a community foundation to receive and hold such trust. This can best be achieved by having the parallel foundation or a community foundation named as the trustee, with the description of the applicable charitable purpose contained in either the trust document itself or in the objects of the parallel foundation or a community foundation being sufficiently broad enough that the charitable purpose extends beyond simply naming the intended charity in the event of such charity’s dissolution or insolvency.

I. CONCLUSION

Before drafting a restricted charitable purpose as either a testamentary or *inter vivos* trust, it can be seen from the discussion in this paper that it is important to understand what a charitable purpose trust is, as well as the duties and obligations that boards of directors of charities have in terms of managing and investing the funds that are subject to a charitable trust. As well, drafting restricted charitable purpose trusts necessitates an understanding of the restrictions that can be applied, since there can be significant legal consequences associated with different restrictions

¹¹⁴ For a more detailed discussion of the Christian Brothers decisions and the exigibility of restricted charitable purpose trusts, see Terrance S. Carter, *supra* note 1.

that the charity and the donor will need to be aware of before such restrictions are included in the terms of the trust.

Many donors prefer making gifts that are subject to restricted charitable purpose trusts because it allows them to retain some measure of control over their gift, and provides better assurance that their philanthropic objectives will be advanced. By contrast, charities usually prefer receiving unrestricted gifts, since restricted gifts may involve significant legal and administrative burdens for the charity. Regardless, restricted charitable purpose trusts are at present and will continue to be an important part of fundraising for charities. Moreover, given the increased demands on fundraising by charities and the associated need for innovative and sophisticated gifts, there is little doubt that the importance of addressing and understanding the issues involved with restricted charitable purpose trusts will continue to be an important aspect of funding for charities in the future. For these reasons, lawyers advising charitable clients and donors need to be aware of the legal duties and resulting consequences associated with establishing restricted charitable purpose trusts. It is hoped that this paper will help in this regard.

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