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**Do's and Don'ts on How to Structure
an Endowment Agreement
(Power Point Presentation)**

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Overview

- What is an Endowment?
- What Are the Advantages of an Endowed Gift?
- What are the Tax Implications of an Endowed Gift?
- What are the Income Tax Requirements of an Endowed Gift?
- What Should be Considered in Structuring a Donor Endowment Agreement?

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- What Should be Considered in Structuring a Board Endowment Fund?
- How Should an Endowed Gift be Managed Once Received?
- What Preventative Steps Can be Taken to Reduce Liability Involving Endowed Gifts?
- What Should Be Done To Protect Endowed Gifts?

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What is an Endowment?

- An endowment is a gift whereby the capital is held for at least 10 years or in perpetuity
- An endowment can be created by either the donor through an endowment agreement (donor endowment agreement) or by the board of a charity in creating an endowment fund (board endowment fund)
- Under the *Income Tax Act*, an endowed gift is now referred to as “enduring property”

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

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- What Are the Advantages of an Endowed Gift?**
- It permits the creation of a capital fund on a long term or perpetual basis in order to fund either specific projects or the general operating costs of the charity
 - It creates long term stability by balancing possible fluctuations in yearly fundraising
 - It allows donors to create a fund in the name of themselves or their families and have a lasting impact on charitable programs

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- It permits the creation of both large segregated endowed funds as well as smaller contributions to existing endowed funds of a charity
- If an endowment fund is operated through a parallel foundation, then the endowment fund can be protected from creditors of the operating charity

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What are the Tax Implications of an Endowed Gift?

- An endowed gift, i.e. a gift where the capital is held for at least 10 years (now enduring property), has tax implications under the *Income Tax Act*
- An endowed gift is excluded from the 80/20 disbursement quota of the recipient charity
- A transfer of an endowed gift between charities will now be exempt from the 80/20 disbursement quota

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- An endowed gift though will be subject to the 3.5% disbursement quota on investment assets for foundations and for charitable organizations if the charitable organization received charitable status after March 23, 2003, or, for charitable organizations that received their charitable status prior to that date, after 2008

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

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- Any disbursement of capital gains or original capital beyond this limit will result in 80% of what is expended being added back on to the disbursement quota of the charity
- The transfer of an endowed gift can be categorized as either an enduring property or specified gift, but transfers involving a specified gift will mean that the transferor will lose the benefit of receiving a credit to use to meet its own disbursement quota

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What are the Income Tax Requirements of an Endowed Gift?

- It must meet the statutory requirements under the *Income Tax Act* for a ten year gift
- An endowed gift must be subject to trust or direction and held for a period of not less than 10 years
- The following formal requirements also must be met:
 - Executed by donor for each gift
 - Clearly identify donee charity including name and registration number

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- Amount of gift must be indicated
- Date that the gift is made must be shown
- Name and address of donor must be clearly set out
- Serial number of official donation receipt must be indicated
- The information must be attached to charity's duplicate copy of receipt

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What Should be Considered in Structuring a Donor Endowment Agreement?

- Does the donor endowment fund consist of monies or gifts in kind, i.e. shares?
- If it is a gift in kind, do the new anti-tax shelter provisions apply pertaining to the valuation of the gift?
- Is the capital of the fund to be held in perpetuity or for a period of at least 10 years?

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- If the fund is to be held for at least 10 years, when can the capital be expended and for what purpose?
- Is there a minimum amount required to establish a donor endowment agreement?
- Are further contributions of capital permitted and, if so, are there any restrictions on how and from whom they can be received?

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- What is the purpose of the fund, i.e. is there a restriction in relation to the use of the income and/or capital?
- Can the charity encroach on the capital gains earned on the endowed gift?
- Can the charity encroach on capital after 10 years and, if so, under what circumstances?

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- Is the investment policy of the charity to be incorporated by reference into the endowment agreement or is the donor allowed to impose specific investment terms of reference on the gift?
- Is the charity able to charge a reasonable administrative charge against the income of the endowment fund?

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- Does the charity have a disbursement policy to determine how much income is to be paid out each year and how much is to be reinvested?
- Does the endowment agreement permit a change of trustee of the endowment fund to another charity, such as a parallel foundation?
- Does the endowment agreement include a *cy pres* clause to permit the charity to change the purpose of the gift in the event the original purpose becomes impossible or impractical?

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- Does the endowment agreement include a determinable gift to protect the endowment gift in the event of the insolvency, bankruptcy or winding up of the charity?
- Does the endowment agreement permit amendments to the administrative terms of the agreement?
- Does the endowment agreement address due diligence concerns under the anti-terrorism legislation?

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- Is the donor asked to acknowledge that they have been advised to seek independent legal or tax advice?
- Has the board of a charity authorized the signing of the endowment agreement?

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What Should be Considered in Structuring a Board Endowment Fund?

- The board of the charity will normally create the terms of a board endowment fund by board resolution
- Is there a board resolution to authorize each board endowment fund?
- The substantive terms of a board endowment fund are generally similar to the terms of a donor endowment agreement as described above

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

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How Should an Endowed Gift be Managed Once Received?

- Identify the nature of the endowed gift
- Review and approve donor restrictions
- Effective ongoing management of endowed gift
 - Deposit the endowed gift into the bank account of the named charity

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- Invest the fund in accordance with applicable investment powers
- Do not borrow against the endowed gift
- Commingle endowed gift only in accordance with the regulations in Ontario and not with any general funds of the charity

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What Preventative Steps Can be Taken to Reduce Liability Involving Endowed Gifts?

- Public fundraising appeals should state that any surplus funds will be used for the general charitable purposes of the charity
- Ensure that testamentary endowed gift includes a *cy prês* clause that will allow the charity to amend the purpose of the gift
- Ensure that documentation creating endowed gift trusts include the words “in trust” in accordance with recent legislation

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What Should be Done To Protect Endowed Gifts?

- Utilize an arms-length parallel foundation
- Utilize a community foundation or trust company
- Structure a gift as a determinative gift with a gift over to another charity
- For more information, see www.charitylaw.ca article on “Donor Restricted Charitable Gifts Revisited: A Practical Overview”

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