Viewpoint

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Advising on Philanthropy: The Role of Lawyers

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Philanthropy has developed in Canada with only a minimum of input from professional advisors. Traditionally professionals have not given philanthropy the attention which it requires and so the role of advisor has frequently been played by those who have not been very professional in their delivery of services to charities. It is a situation for which both charities and professionals must share the blame. In this paper I have chosen to restrict my comments to the role of lawyers. Accountants, fund-raising consultants and representatives of the insurance industry are also professionals who advise charities but, as some of my comments are negative, I will confine my criticisms to the profession I know best—my own. Members of other professions may decide for themselves whether my comments apply to them.

Charities are very concerned about the costs of hiring professional help outside of the area of marketing. Their solution has often been to find a sympathetic lawyer or accountant to incorporate them and set up the books. They have asked professionals to do this on a voluntary *pro bono* basis and "rewarded" them with a seat on the board or a title such as "Honorary Solicitor". Because the professionals were not able to bill for this work, they frequently assigned it a very low priority and, if they could, gave the file to a student or a paralegal.

The results could have been predicted by any busy and experienced professional: the charity received the calibre of expertise and service for which it paid and began its relationship with its lawyer with an experience which did not engender confidence. However, because of the fee arrangement, the charity did not complain and the lawyer was thanked profusely to his or her face, although the comments when he or she was not around were not nearly so flattering. Both parties concluded this first interaction with the sincere hope that they would not be required to have much further contact.

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This experience was repeated so frequently that most lawyers found it a burden to develop any expertise in the charitable area because being recognized as having either knowledge or sympathy meant being approached by even more charities seeking *pro bono* services. Consequently, very few lawyers developed any sophistication in the law relating to charities.

As Canadian philanthropy increased, the affairs of charities became more complex and they began to realize they were not receiving the level of expertise they required. They began to recognize the causal relationship between the low calibre of service they were receiving and their failure to pay fees and began looking around for paid legal assistance. What the charities then found was that the expertise did not exist even if they were willing to pay. Because professionals could not afford to develop expensive expertise on a *pro bono* basis, the expertise was not developed. This second interaction between charities and their lawyers was usually as unsatisfactory as their experience at incorporation.

In recent years both charities and lawyers have moved to remedy these problems. Charities have not found it easy but they are beginning to pay for professional services. It is not cheap but it is to be hoped it will prove much less expensive in the long run if they obtain the best advice the first time around. Lawyers are billing, but at the same time they realize that one file or one charity cannot sustain the entire cost of educating the lawyer in this field. Both are now moving gradually to a more professional relationship which will be mutually beneficial.

One of the problems besetting philanthropy in Canada is that leadership in the development of testamentary giving and planned giving instruments has usually come from religious charities. This is very different from the United States where universities like Stanford and Harvard have been the leaders. I know religious schools in small towns on the Prairies which have millions of dollars in instruments like charitable annuities whereas major universities have often not issued a single one. Stanford is able to demand the highest level of technical competence from its attorneys when it is developing planned giving instruments but small religious organizations have traditionally not been too assertive or demanding with regard to the calibre of the professional advice they obtain. Consequently, there are many planned giving instruments being employed in Canada today which have not been developed with the benefit of adequate legal and tax advice.

Today, charities are moving into new forms of fund raising which require more and better technical advice. To date, most have relied very heavily on direct mail and personal arm-twisting for soliciting *inter vivos* donations. These were usually small cash gifts which provided a steady flow of income. At most, there was periodically some reference in the printed fund-raising materials to the importance of charitable bequests.

In recent years, as government support has decreased and needs have increased, there has been a dramatic increase in the emphasis placed on wills and planned giving. An analysis of the demographics of our society shows why. We have an aging but generally affluent segment of the population which, statistics from

Revenue Canada indicate, gives much more to charity than do the younger generations. In fact, the group which gives the highest percentage of its disposable income to charity in Canada is made up of women over the age of 65.

Members of the legal profession have an important role to play in the charities' new giving programs when they draw wills for people with charitable intentions. The potential donor will be looking for advice on structuring the gift as well as drafting the will and it is important that lawyers become more familiar with how charities operate so they can help to achieve the optimum balance between the specific desires of the donor and the most urgent needs of the charity. For example, the lawyer has a critical role to play in dissuading the type of donor who is determined to leave his or her house on Maple Street to charity on the unalterable "trust" that it be maintained in perpetuity as a sanctuary for lost cats found wandering in the neighbourbood. Without promoting the cause of any particular charity, the advisor can quite properly fire the imagination of donors who want to give more than a simple bequest of a percentage of residue by suggesting consideration of a special research project, or a permanent memorial which can be either a "bricks and mortar" building program or a named endowment fund.

Charities need to be much more helpful to lawyers by doing a better job of communicating the nature and extent of their services to a wider community. It would be shocking for the large, widely recognized charities like the Salvation Army or the Cancer Society to learn how little professionals actually know about what they do. Usually lawyers only have contact with these organizations through fund-raising materials (which they seldom read). Yet charities frequently operate on the assumption that because they mailed a brochure or fund-raising appeal letter to 14 zillion people, every lawyer in the country has not only received it, but read it, and committed it to memory. I believe that one of the reasons that two-thirds to three-quarters of all personal charitable donations go to religious oganizations is that the money is coming from people who are involved in the recipient religious organizations and know what the organizations do.

One of the reasons that so many hundreds of millions of dollars have gone to African famine relief in the last few years is that both the need and the operations of relief charities have been effectively communicated through television. It is no mere coincidence that the money started flowing when the media began publicizing the crisis rather than when the famine began. High-powered television fund-raising programs are frequently criticized for being too slick and manipulative. I'm not sure that people respond because they are manipulated. I think they are responding because they believe they understand what the organization actually does.

It is unreasonable to expect people to give the quantum of money which is involved in a will or a planned gift if they do not understand how it will be used. That is why donors frequently turn to their lawyers for advice in this regard. Unfortunately, the lawyers, through no fault of their own, are seldom in a position to offer any insights or alternatives because charities have never

approached them to explain what they do but only to seek a donation or free services.

Professional advisors to charities in the field of direct mail fund raising provide a valuable service to charities. I wish that I, as well as they, could learn more about, and even come to understand, the impact of direct mail solicitation on the large donor and planned giving. I am inclined to advise my clients that there are two ways to receive recognition in perpetuity for a charitable gift. One is to give a million dollars for a perpetual endowment or a gift of sufficient size to get their names on a plaque on a building. If that is too expensive, they can give $100 and the direct mail department will ensure that they receive further appeals in perpetuity. I often feel that if fewer people were experiencing the second kind of recognition there might be more people inclined to consider the former.

One of the problems on which lawyers are often expected to advise is the competing financial interests of the charity and the donor's family. Many times the donor has a real desire to give a substantial amount of capital *inter vivos* or a large portion of the residue in the will. The donor is concerned both about future financial needs and the claims of the children on the estate. The lawyer is often asked to help the testator to decide what is prudent.

There are several possible responses. The first priority is to ensure that the donor's own financial future is secure. The most conservative advice is to tell donors not to take any chances while they are alive and that the children will probably challenge the will if more than a token bequest is made to charity.

That advice may be prudent but it does not necessarily fulfil the wishes of the client. The lawyer should, instead, outline other ways of fulfilling donors' charitable aspirations while protecting their financial interests during their lifetimes. These include revocable and irrevocable charitable remainder trusts, interest-free loans, charitable annuities and industry term-certain annuities with assignment of the remainder interest to the charity. If the charity does not have such planned giving instruments, then the lawyer can assist it to develop them.

It should be remembered that it is important for lawyers to assist their clients to fulfil their charitable wishes, not to advise them what the lawyers would do if it were their money. Unfortunately, lawyers are usually not large contributors to charity themselves so they may have a personal bias against philanthropy. It should also be emphasized that it is not their place to change or divert the donation from the donor's favorite charity to one preferred by the lawyer.

If the client decides to delay all charitable donations until after death, he or she must be advised about the spouse's and children's rights to challenge the will under the dependant's relief legislation applicable in each province. In British Columbia that is the *Wills Variation Act* which allows any spouse or child to apply to the court to vary a will. The traditional conservative advice has been to recommend against a charitable bequest if the children are expected to oppose it. While this is appropriate in many circumstances, the client should be advised

of ways to draft the will and arrange affairs so as to reduce the chance of such a challenge succeeding, before all charitable intentions are abandoned.

In 1980 I was asked to draw a will for an elderly widower who fully expected the charitable bequests to be contested. I took a great deal of care to make sure that the file contained my notes as to his testamentary capacity, his intentions and my opinion as to any undue influence. There was a witnessed signed statement in the file, stating why he did not want the money to go to his family, which complied with Section 2(3) of the *Wills Variation Act.* In 1984 he wanted to make a minor variation in his will. After meeting with him in his hospital room I recommended against changing his will because I was confident that a challenge based on mental capacity or undue influence would fail against the 1980 will but that this outcome was less likely in 1984 when he was obviously close to death. The changes were too insignificant to warrant the risks.

He died a month later. The relatives whose intentions he feared came out of the closet exactly as he had predicted. Their lawyers wrote me the intimidating letters we had anticipated. When they were advised of all the evidence which would have come out at trial, they withdrew without litigating and a quarter of a million dollars passed to charity as the client had hoped. However, it passed without challenge only because the necessary effort and money were expended to prepare the legal groundwork for a successful defence prior to the testator's death.

Preparing defences while preparing the will, will not always avoid litigation. If the potential beneficiaries still want to challenge the testamentary bequest, the charity has a difficult legal decision. Its public relations department and direct-mail fund raisers do not want the publicity of a court battle so the charity usually folds or settles. The negative impact of always settling is not considered. Charities should remember that, knowing that the charity will not fight if challenged, testators anticipating a challenge frequently decide to spare their estates the embarrassment and make no charitable bequests.

In the estate previously described, the testator at one point abandoned his charitable aspirations because he knew that none of the charities he favoured would engage in a court battle. We solved the problem by naming no charities in the will and giving the estate to an individual on an undisclosed secret trust knowing that he would carry out the charitable bequests and fight any challenge. Refusing to litigate may make life easier for the direct-mail fund raiser but direct mail prospects are not the most likely donors for large charitable bequests. The concern of the planned giving fund raiser should be that the charity not lose credibility with potential donors of substantial bequests because it will not fight to give effect to testamentary wishes.

I believe that there has been a significant shift in peoples' attitudes to testamentary giving in recent years. More elderly people are taking the position that "it's my money" and that they have fulfilled their obligations to their children while raising them. Many of them even consider their children to be spoiled and

ungrateful because they have so much and have struggled so little. Commonly, elderly people who feel this way will just spend their money enjoying some luxuries while they are alive, but at least some are prepared to let charity have what is left over. Charities are sometimes out of step with the mood of that potential donor and give offence by conscientiously stressing the "duty" owed to children before any charitable bequest is made.

One of the most difficult situations in which a lawyer can be called upon to give advice arises when a client with a strong charitable intention is failing in mental capacity so that there is a strong likelihood the testamentary bequest will be challenged. Two weeks ago I was consulted by an American university about a woman who had given it several seven-figure donations and charitable annuities. During her lifetime her husband had endowed three chairs in one faculty. The woman is now 94 and having to simplify the management of her affairs so she wants to make a further multi-million-dollar disposition to the institution.

The woman has hired and fired several lawyers in recent years and is now looking to the development officer of the university for advice. He was inclined to recommend a revocable charitable remainder trust so that he would never be accused of having taken advantage of her. However, both recognize that she has no real need of the money and that she really wants to make the gift while she is still alive. What the development officer has not considered is that as his donor's mind weakens she will probably be more susceptible to more persuasive, and possibly less ethical, charitable fund raisers. Everyone knows she is a generous philanthropist and so she is an easy "mark". A polished presentation from a charity to which she has no links could result in a substantial gift. Considering the woman's history of donations and loyalty to the university, an irrevocable charitable trust or an irrevocable charitable annuity, if not an outright gift, may serve to protect the donor's interests as much as the charity's.

Recently I was in Alberta consulting with a charity which is in the process of returning tens of thousands of dollars because a revocable charitable trust was revoked. A wealthy elderly supporter of the charity had a blind wife who is now 90 and confined to a wheelchair. Over the years the man had given the charity a total of several hundred thousand dollars for charitable annuities to benefit his wife. He never took any of the monthly payments which amounted to several thousand dollars a month, because he never needed the money. Instead, he left the money as an interest-free loan with the charity. Whenever it totalled about $50,000 he would purchase another charitable annuity.

The charity always went out of its way to stress the importance of loans as opposed to outright gifts and revocable, instead of irrevocable trusts so that the wife was always protected. Things were set up so that all she had to do was ask and she would be given the money on loan. In fact there were far more assets than she could conceivably require even with the extra expense of her incapacities.

The husband died several months ago and the widow's nephew acquired her power of attorney. Among his first actions was a demand that all loans be repaid

and all trusts immediately revoked. The charity immediately returned everything but the annuities which were irrevocable contracts. If they had been revocable, the charity would have had to come up with hundreds, rather than tens of thousands of dollars.

It is easy to condemn the nephew for greed and to suggest a possible conflict of interest as his aunt has no children and he may benefit from her estate upon her death. He is certainly not doing what the husband would have done or intended to happen. Before we go too far down that road, however, let me tell you that if I were the legal advisor to the nephew, I would advise him that he has no choice but to do exactly what he did. His duty is to the financial interests of the widow; not to the wishes of the deceased. He is in far greater danger of breaching his duty by leaving money in an account which is not earning interest than by putting it into a commercial account. The money is not his to give and the widow does not have the legal capacity to give him direction or waive his liability.

By encouraging a revocable instrument, the charity has managed only to frustrate the wishes of the donor at great expense to itself. Notwithstanding the fact that the widow is as pathetic a beneficiary as possible, nothing is being added to her financial security because all of her possible needs have been provided for in other ways. As is so often the case, the charity was prepared to pay for legal advice only after the fact when it was too late to change anything. The cost of the fees for advice when the arrangements were entered into would have been a small fraction of the savings realized by structuring the planned gift differently.

Another problem can arise when an elderly donor waits too long and no longer has the mental strength to give away a million dollars. I am working now with a man who has wanted for years to be a million-dollar donor to a building program at his favourite charity. Unfortunately, the charity was not in a position to begin the project until this year. The man is 84 and could have passed for 60 until he suffered a minor stroke several months ago. Now he could pass for 90 and, while he has mental capacity, cannot make a "big decision". His charitable intention has not changed, he is simply unable to bring himself to give it effect. His business affairs show the same behavioural pattern. He is comfortable making the small decisions but continually puts off making big decisions so that it is evident that he can no longer grapple with them. For most of us, giving a million dollars would be a certifiable act of insanity, but for philanthropists it is a disciplined decision requiring a degree of mental strength which elderly people sometimes lose.

Many charities are now moving into the field of wills and planned giving. They should also be moving into soliciting gifts of assets and shares. The amendments to Section 110(2.2) of the *Income Tax Act* which were passed into law on February 13, 1986 make it possible for a donor to give shares or other assets to any charity and elect any value for the purposes of the charitable receipt that is not less than the property's adjusted cost base and not greater than its fair market value. This moves Canadian tax law closer to that of the United States but still falls far short of the tax advantages of American "fire-sale-to-charity" transactions.

At the present time, United States charities receive a significant amount of their incomes from asset gifts. Canadian charities receive cash gifts almost exclusively. Lawyers will have an important role in assisting charities to understand the implications and procedures involved in handling asset transfers. There will be a significant increase in professional work with donors as well when the optimum value of a gift and receipt are calculated. There will also be more legal work involved in documenting the transfers themselves.

Most small donors who do not give up to the maximum 20 per cent of income will elect the highest possible price and they will get two dollars worth of deductible receipt on the capital gain for every one dollar of taxable income. Of course, they will get a receipt at no tax cost to them for the value of the adjusted cost base provided that there is no recapture on depreciation.

The February amendments are most important to large donors who will now be able to give large blocks of shares without triggering more capital gains tax than they can protect with their deductions for the donation. Some holders of substantial blocks of wealth are prepared to move into charity now that these amendments are in place. Under the old 110(2.2) a donor could not give shares. Also, the donated property at the time of the donation, had to be regarded reasonably as being suitable for use by the recipient charity directly in its charitable activities. Both of these restrictions have been removed. But it is important to note that the gift must still be "capital property" (which excludes inventory) for 110(2.2) to apply.

The large philanthropist who is known to be a very substantial donor is another source of funding that charities should learn to cultivate. Working with the large donor is an art in its comparative infancy in Canada. Our laws do not permit the sophisticated giving instruments that have been developed in the United States which allow generation skipping or income returns to the settlor, e.g., the charitable lead trust, the charitable remainder unitrust or the pooled income fund. Nor do we have the widespread pools of accumulated wealth found in the United States where statistics indicate that one person in every thousand is a millionaire.

However, I refuse to believe that professional advisers in Canada cannot create a better environment than now exists for bringing the philanthropist's charitable aspirations to fruition. I believe that lawyers could play as important a role as charities in increasing the limited number of large charitable gifts made in Canada. Traditionally, Canadian educational institutions, hospitals and even health, welfare and arts charities have turned to government rather than to individuals for the large dollar. This cultural bias is being forcibly, if unwillingly, changed by government cutbacks. Charities are reaching out, even if in a floundering way, to new sources of funding.

What charities often fail to recognize is that none of the major sources of funding—wills, planned giving, asset transfers and major philanthropists—can be tapped without involving the donor's lawyers. As counsel for donors we

lawyers sit in judgment on the charities' requests and marketing efforts whether we want to or not. Our attitude to the problems inherent in charitable giving will have considerable influence on whether the gift is made or not. Our outlining of the problems in a potential testamentary challenge to a charitable bequest will be fatal to philanthropy if we cannot, or do not, put forward a potential solution at the same time. I believe that we have a clear professional duty to point out, rather than minimize, the problems donor clients can face. I believe, however, that our professional duty extends to creating reasonable, if not guaranteed, solutions.

In the United States, the Council on Foundations and Yale University are completing a two-year study of "Foundation Formation, Growth and Termination". They have had unprecedented access to 135 major philanthropists all over the United States as well as more than 100 of their professional advisors. One of the most frequent comments of these philanthropists is that their attorneys and accountants consistently advise against the forming and funding of a private foundation. This finding was not a complete surprise but the extent of the impact of that counsel had not been realized.

I am cetainly not in a position to adopt a "holier than thou" attitude to advisors who offer this kind of advice. I have advised many clients that the private foundation is the least attractive option when they are considering vehicles for charity. However, advising clients of preferred methods of giving is not advising them not to give. In a paper entitled "Tax Planning for Charities" which I delivered at the 1984 Annual Conference of the Canadian Tax Foundation, I indicated that I was not very happy with the rules governing private foundations in Canada which were passed into law in 1984. Ever since the *Tax Reform Act of 1969,* United States attorneys who have been advising their clients to avoid using private foundations have probably been giving good advice. When governments pass legislation hostile to foundations they must expect philanthropists to withdraw from, or avoid funding, foundations which are, after all, entirely voluntary acts of generosity. While the 1984 Canadian legislation made a tremendous improvement in the treatment of charitable organizations, it adopted the hostile United States attitude towards private foundations.

Again, the solution to the problems arising from legislation is to create positive solutions which serve both the philanthropist and charity. Large donors will find there are many creative alternatives to a private foundation. If a businessman comes into our office and tells us how he wants a corporate re-organization or to arrange a sale of assets, we almost invariably find flaws in what has been proposed but we do not then send him away with the simple response that what he proposes does not make sense or cannot be done. We roll up our sleeves and draw up a proposal which *does* make sense and balances his business objectives with tax considerations.

I believe, as lawyers, we fail both our clients and our communities when we do not apply the same ingenuity, creativity and technical skills to enabling our clients to fulfil their charitable aspirations that we would apply to their business

needs. None of the million-dollar charitable transactions in which I have been involved has gone ahead as originally proposed. Others, in which I am currently involved, have not been completed only because I (as legal adviser to the donor) and the charity, have not yet been able to formulate a structure or proposal which will give my client the necessary level of comfort. Charities should remember that increasing the level of tax benefit and reducing the technical risks greatly decreases the degree of donor altruism that must be generated to complete a large gift.

Canada at this time desperately needs the skills and services which its educational institutions and other charities have to offer. To maintain their service to society, these charities must have new sources of funding. That funding will only come if lawyers are willing to work with their clients and assist them to fulfil their charitable aspirations in a responsible way which does not leave them financially vulnerable. Charities and lawyers must come to understand their mutual dependence if they are going to serve both their clients and their communities.

If the observations in this paper are correct, as I believe they are, there is cause for finger pointing. That would be counter-productive and self-defeating. Both the legal profession and charities must share the blame for the present unsatisfactory level of philanthropy in Canada. If we are to see major improvements, charities must raise the technical standard of their planned giving instruments and legal structure so that lawyers can responsibly recommend sophisticated fund-raising proposals to their clients. Lawyers must deliver more expert services more expeditiously so that charities will feel like the important clients they should be. Both must come to grips with the difficult but crucial issue of fees. If lawyers' only contact with charities was not, too often, a request for free services or cash donations they might have more sympathy for, and willingness to encourage and facilitate, their clients' charitable aspirations.

It is my belief that increased charitable funding in the future will depend, at least in part, on the successful resolution of the problems I have described and a new spirit of empathy and co-operation between lawyers and charities.