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BILL S-222 PROPOSES TO ELIMINATE THE "OWN ACTIVITIES" REQUIREMENT FOR CHARITIES

By Terrance S. Carter and Theresa L.M. Man*

A. INTRODUCTION

A NEW BILL introduced in the Senate will hopefully provide registered charities in Canada with much needed and long awaited reform concerning how they can work with organizations that are not registered charities or other types of "qualified donees."[1] On February 8, 2021, the Honourable Ratna Omidvar, Senator for Ontario, and former co-chair of the Special Senate Committee on the Charitable Sector,[2] tabled Bill S-222, the *Effective and Accountable Charities Act* (the "Bill"),[3] which received first reading the same day. The Bill proposes significant changes to several provisions in the *Income Tax Act* ("ITA")[4] governing charities. In a social media posting published on February 14, 2021, Senator Omidvar said her intention for the Bill is to enable Canadian charities "to establish equal partnerships [with] non-

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[1] For a full definition of "qualified done", see *ITA*, s. 149.1(1). In general terms, s. 149.1(1) of the *ITA* provides that qualified donees are organizations that can issue official donation receipts for gifts that individuals and corporations make to them under paragraphs 110.1(1)(a) and (b) and subsection 118.1(1).

[2] The Special Senate Committee on the Charitable Sector was appointed by the Senate of Canada to "examine the impact of federal and provincial laws and policies governing charities, nonprofit organizations, foundations, and other similar groups; and to examine the impact of the voluntary sector in Canada," and released its final report on June 23, 2019. For further information, see Terrance S Carter, *January 2018 Charity & NFP Law Update*, "Legislation Update" online: Carters Professional Corporation <https://www.carters.ca/pub/update/charity/18/jan18.pdf#tc1>, and Terrance S. Carter, Theresa L.M. Man, and Ryan M. Prendergast, *Charity & NFP Law Bulletin No. 451*, "Special Senate Committee on Charitable Sector Releases Final Report" (27 June 2019) online: Carters Professional Corporation <https://www.carters.ca/pub/bulletin/charity/2019/chylb451.pdf>.

[3] *An Act to amend the Income Tax Act (use of resources)*, 2nd Sess, 43rd Parl, 2021, (first reading 8 February 2021), online: <https://www.parl.ca/LegisInfo/BillDetails.aspx?Language=E&billId=11099585> ["Bill S-222"].

[4] RSC, 1985, c 1 (5th Supp) [ITA].

charities, while still ensuring accountability."[5] Laws governing Canadian charities must "catch up with" the rest of the world, Sen. Omidvar added.[6] The Senator's efforts in this regard are expected to receive broad support from the charitable sector in Canada.[7] As well, a number of charity lawyers in Canada (including the authors of this *Bulletin*) have signed an open letter explaining the need for reform to the ITA and to eliminate the "own activities" requirement.[8]

This *Bulletin* explains the background for the problems that currently exist for registered charities in working with non-charities, because of archaic requirements in the ITA that charities must meet the "own activities" test. These provisions have been interpreted by the Canada Revenue Agency ("CRA") to require that a charity must exercise onerous "direction and control" when working through third parties that are neither registered charities nor other types of "qualified donees." The *Bulletin* also reviews the proposed changes in the draft Bill and the anticipated benefit that it will have on the operation of charities in Canada.

B. BACKGROUND[9]

1. Requirements under the ITA

Current ITA provisions have been generally interpreted by the CRA to mean that a registered charity can only use its resources in two ways, whether inside or outside Canada: on their own activities and on gifts to qualified donees. Specifically, charitable organizations are required to primarily carry on their own charitable activities and may, if they wish, disburse not more than 50% of their income annually to qualified donees. The requirement that charitable organizations must devote all of their resources to

[5] Senator Ratna Omidvar, "I have tabled the Effective + Accountable Charities Act to enable #charities to establish equal partnerships w/ non-charities, while still ensuring accountability: http://ow.ly/OxpR50DwFqC. Laws governing CA charities must catch up with rest of the 🌎! #S222 #SenCA #EqualPartners" (14 February 2021 at 3:45 pm), online: Twitter https://twitter.com/ratnaomi/status/1361053866410844168.

[6] *Ibid.*

[7] See, for example, Canadian Centre for Christian Charities, "Bill S-222: From Direction and Control to Reasonable Steps" (10 February 2021) online: <https://www.cccc.org/news_blogs/noteworthy/2021/02/10/bill-s-222-from-direction-and-control-to-reasonable-steps/>, and Calgary Chamber of Voluntary Organizations, "Senator Ratna Omidvar tables Bill S-222: The Effective and Accountable Charities Act" (9 February 2021) online: <https://www.calgarycvo.org/news/senator-ratna-omidvar-tables-bill-s-222-the-effective-and-accountable-charities-act>.

[8] "Making It Easier to Do Good: Doing Away with the 'Own Activities' Requirement" (19 February 2021) online: Carters Professional Corporation <https://www.carters.ca/pub/bulletin/charity/2021/Making-It-Easier-to-Do-Good.pdf>.

[9] This section of this *Bulletin* is largely taken from a paper originally published for the Pemsel Foundation, which reviews in detail the historical development of the current ITA regime. For more information, see Terrance S. Carter & Theresa L.M. Man, "Direction and Control: Current Regime and Alternatives" (Occasional paper delivered for The Pemsel Case Foundation, Edmonton, 2020), online: <https://www.carters.ca/pub/article/charity/2020/Direction-and-Control-Current-Regime-and-Alternatives.pdf> [Pemsel].

"charitable activities carried on by the organization itself" is interpreted by the CRA to mean that they have to conduct their own activities, and thereby is often referred to as the "own activities" test.

Public foundations are required to give more than 50% of their income annually to other qualified donees but, provided that the threshold is met, may also carry on charitable activities. Private foundations, however, may carry on their own charitable activities and may disburse funds to qualified donees without restriction.

With regard to the "own activities" test, the CRA requires that a charity cannot merely be a conduit to funnel money to an organization that is not a qualified donee, but instead must direct and control the use of its resources when carrying out activities through an intermediary.[10] This is known as the CRA's administrative requirement of "direction and control" policy, based on its interpretation of the requirement in the ITA that charitable organizations devote all their resources "to charitable activities carried on by the organization itself."[11] Many in the sector have consistently expressed concerns with the CRA's interpretation of the "own activities" test and the direction and control mechanism for years.[12] Although the CRA has updated their guidances on November 27, 2020, by relaxing some of the more onerous CRA requirements in the previous guidances, there were no substantive changes to the CRA's direction and control requirements.[13]

2. Purported Historical Justification for "Own Activities"

The requirement that "all the resources" of a charitable organization be "devoted to charitable activities carried on the by the organization itself" has remained the same since 1950, despite various amendments to the ITA over the years. The requirement that foundations be constituted and operated for charitable purposes also stems from wording that was put in place in the ITA in 1950. It has been observed that the regime in 1950 was intended to prevent charitable organizations from "circulating funds endlessly or

[10] Canada Revenue Agency, Guidance CG-002*: Canadian registered charities carrying on activities outside Canada*, online <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-002-canadian-registered-charities-carrying-activities-outside-canada.html>; and Guidance CG-004*: Using an intermediary to carry on a charity's activities within Canada* ("CG-004"), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/using-intermediary-carry-a-charitys-activities-within-canada.html>.
[11] For examples of Canadian case law dealing with "direction and control" see Pemsel, *supra* note 9 at 18.
[12] Pemsel, *supra* note 9 at 11.
[13] For further information on the updated Guidance CG-002 and CG-004, see Terrance S Carter and Theresa LM Man, *Charity & NFP Law Bulletin No. 484*, "CRA Updates Guidances on Charities Using Intermediaries" online: Carters Professional Corporation <https://www.carters.ca/pub/bulletin/charity/2021/chylb484.pdf>.

sheltering them without actually using them for charitable relief."[14] The regime meant that "if any part of the funds of the organization are distributed to other institutions or organizations which carry on charitable activities, the distributing organization will not qualify" as a charitable organization.[15]

It is highly doubtful whether the historical basis or rationale for the requirement that charitable organizations must devote all their resources to charitable activities carried on by the organizations themselves continues to be valid in 2021, more than 70 years after the distinction between actively carrying on charitable activities and charitable funders was first entrenched in the ITA in 1950.

3. Practical Problems Associated with Own Activities/Direction and Control

The charitable sector has over the years repeatedly raised concerns about the difficulties and challenges associated with the direction and control mechanism.[16] The following is a summary of some of the key difficulties and challenges:

- The direction and control mechanism requiring the programs to be the "own activities" of the funding Canadian charity in essence creates a legal fiction in order to satisfy the requirements of the ITA as interpreted by CRA. This mechanism is outmoded, impractical, inefficient, unpopular, and built upon the fiction that everything that a charity does through a third party intermediary must be structured as the activity of the charity itself when the reality is that the activity is, more often than not, intended to be the activity of the recipient third party. As a result, the direction and

[14] Carl Juneau, "The Canadian Income Tax Act and the Concepts of Charitable Purposes and Activities" (2016) The Pemsel Case Foundation Occasional Paper at 4-5, online: <https://thephilanthropist.ca/2016/10/the-canadian-income-tax-act-and-the-concepts-of-charitable-purposes-and-activities/>.
[15] R Appleby, "The Taxation of Charitable Institutions" (1973), 1:2 Philanthropist 17 at 19.
[16] For further details on these difficulties and challenges, see Pemsel, *supra* note 9. See also, *e.g.* Andrew Valentine, "Foreign Activities by Canadian Registered Charities: Challenges and Options for Reform" (21 November 2016) The Philanthropist, online: <https://thephilanthropist.ca/2016/11/foreign-activities-by-canadian-registered-charities-challenges-and-options-for-reform/>; Malcolm D Burrows, "New Series: Canadian Charities Working Internationally" (22 March 2015) The Philanthropist, online: <https://thephilanthropist.ca/2015/03/new-series-canadian-charities-working-internationally-2/>; John Lorinc, "The Problems with Direction and Control" (6 April 2015) The Philanthropist, online: <https://thephilanthropist.ca/2015/04/international-series-the-problems-with-direction-and-control/>; Juniper Glass, "Do Canada's internationally focused charities operate in an enabling environment?" (20 April 2015) The Philanthropist, online: <https://thephilanthropist.ca/2015/04/do-canadas-internationally-focused-charities-operate-in-an-enabling-environment/>; Evidence presented by various witnesses to the hearing of The Special Senate Committee on The Charitable Sector from February 2018 to April 2019, online: <https://sencanada.ca/en/Committees/cssb/MeetingSchedule/42-1?mode=PAST>; Canadian Council for International Co-operation, "Directed Charities and Controlled Partnerships: A Policy Brief on Charitable 'Direction and Control' Regulation in Canada's International Development and Humanitarian Sector" (15 October 2019), online: <https://ccic.ca/wp-content/uploads/2019/10/Directed-Charities-and-Controlled-Partnerships-Final.pdf>.

control regime has created a fictitious counter reality that charities have extreme difficulty in complying with and which causes charities to become exposed to unnecessary liability.

- Requiring charities to have a top-down approach to exercise "direction and control" to dictate the charitable activities and how they are carried out is fundamentally at odds with current international development philosophy that recognizes the importance of developing empowering partnerships with local communities and non-governmental organizations.

- Many of the CRA's requirements do not clarify which requirements are mandatory and which ones are optional. Failure to follow the steps noted as "recommendations" in CRA guidances may result in CRA audits. These uncertainties often result in charities erring on the side of caution by treating all of them as mandatory requirements and thereby making compliance even more difficult.

- The direction and control requirements are impractical and unrealistic to comply with, and reflect an environment of micro-management that deters and distracts charities from focusing on delivering their charitable programs and ignores the benefit of relying on the expertise of the local partner in an international context doing the work on the ground. Charities are required to exercise direction and control where the monitoring, management and reporting rules are onerous and disproportionate.

- Compliance with the onerous CRA requirements often requires high administrative costs, even in situations where the charity otherwise has no concerns with a trusted foreign partner, and draws scarce resources away from charitable work, representing a poor expenditure of charitable resources and preventing smaller charities from engaging in foreign activities.

- The direction and control mechanism in Canada requiring programs to be the "own activities" of the funding Canadian charity is an outlier in the world and is inconsistent with successful mechanisms utilized by other countries.

- Finally, and in many ways most importantly, given the pressing need for improved relationships with Indigenous communities in Canada, the direction and control requirements arising out of the "own activities" test impose a paternalistic and patronising relationship between charities and

Indigenous communities that those charities wish to work with where those communities are not registered charities or other types of qualified donees (*e.g.* a municipal or public body performing a function of government in Canada).

C. OVERVIEW OF CHANGES PROPOSED IN THE BILL

BROADLY SPEAKING, the Bill proposes to amend the ITA to "permit charities to provide their resources to a person who is not a qualified donee, provided that they take reasonable steps to ensure those resources are used exclusively for a charitable purpose."[17] Among the changes, the Bill proposes to remove the fictitious "own activities" test; expand the definition of "charitable activities"; as well as allow resources to be available to non-qualified donees as part of legitimate charitable activities, provided that "reasonable steps" are taken, as discussed above, and thereby holding charities to an objective standard.

First and foremost, the most important proposed change is the removal of the "own activities" test by making similar changes to various provisions in sections 149.1, 188, 188.1, and 189. This is done by requiring charities to carry on "charitable activities" instead of "charitable activities carried on by it." These changes affect ITA provisions governing the definition of "charitable organizations" and the meaning of "non-qualified investments"; revocation of charitable organizations, public foundations, and private foundations; how charities may devote their resources for charitable activities; as well as the calculation of the disbursement quota, and revocation tax.[18]

With the "own activities" removed, the Bill proposes to allow charities to make their resources available to non-qualified donees, provided that the charities takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose. This is achieved by proposing two changes.

Firstly, the Bill proposes to expand the definition of "charitable activities" in subsection 149.1(1), which currently allows charities to engage in public policy dialogue and development activities. In this regard, the amended definition would allow a charity to make its resources available to non-qualified donees

[17] Bill S-222, *supra* note 3, see Summary.
[18] *Ibid*, cl 2(2) of Bill S-222 amending paragraph (a) of the definition of "charitable organization" in s 149.1(1) of the ITA; cl 2(3) amending paragraph (e) of the definition of "non-qualified investment" in s 149.1(1) of the ITA; cls 2(4)-(11) amending the revocation provisions in ss 149.1(2)-(4.1) of the ITA; cls 2(12)-(13) amending provisions concerning devotion of resources for charitable activities in ss 149.1(5)-(6), (10); cl 2(14) amending disbursement quota provisions under ss 149.1(20)-(21) of the ITA; and cls 3, 4 and 5 amending revocation tax provisions under ss 188(1.1), 188.1, and 189 of the ITA.

provided that the charity takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose in accordance with new subsection 149.1(27). As such, the expanded definition of "charitable activities" reads as follows:

> "charitable activities" includes
>
> (a) public policy dialogue and development activities carried on in furtherance of a charitable purpose; and
>
> (b) making resources — including grants, gifts or transfers — available by transactions, arrangements or collaborations of any kind whatsoever in furtherance of a charitable purpose to a person that is not a qualified donee if those resources are made available by a charity that takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose in accordance with subsection (27).[19]

Secondly, the Bill proposes to insert a new subsection 149.1(2.1) to explicitly clarify that charitable foundations (which includes public foundations and private foundations) are also permitted to make their resources available to non-qualified donees, provided that they take reasonable steps to ensure those resources are used exclusively for a charitable purpose in accordance with new subsection 149.1(27). This is because charitable foundations are required under the ITA to be constituted and operated exclusively for "charitable purposes" rather than to conduct "charitable activities." Therefore, the expanded definition of "charitable activities" may not necessarily apply to charitable foundations. As such, the new subsection 149.1(2.1) reads as follows:

> For greater certainty, a charitable foundation, as defined in subsection 149.1(1), may make resources — including grants, gifts or transfers — available by transactions, arrangements or collaborations of any kind whatsoever to a person that is not a qualified donee if the charitable foundation takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose in accordance with subsection (27).[20]

A new subsection 149.1(27) is proposed to be inserted to clarify what exactly constitutes "reasonable steps" to ensure the exclusive use of resources for a charitable purpose. The new subsection 149.1(27) reads as follows:

[19] Bill S-222, *supra* note 3, cl 2(1). See *below* for the language of the new subsection (27) proposed by the Bill.
[20] *Ibid*, cl 2(6).

> (27) A charity is considered to have taken reasonable steps to ensure its resources are used exclusively for a charitable purpose if
>
> (a) before providing resources to a person who is not a qualified donee it collects the information necessary to satisfy a reasonable person that the resources will be used for a charitable purpose by the person who is not a qualified donee, including information on the identity, experience and activities of the person who is not a qualified donee; and
>
> (b) when providing resources to a person who is not a qualified donee, it establishes measures, imposes restrictions or conditions, or otherwise takes actions necessary to satisfy a reasonable person that the resources are being used exclusively for a charitable purpose by the person who is not a qualified donee.[21]

While allowing for greater flexibility in the use of its resources, the Bill indicates the legislative intent to retain accountability for charities in a revised ITA regime, without the excessive restrictions imposed by the "own activities" requirements, and allowing for greater involvement with non-qualified donees.

The Bill provides that the Minister of National Revenue must undertake a review of the provisions enacted by this Bill within five years after the day on which this Bill comes into force.[22] Then, the Minister must, within one year after the review, prepare a report on the review and have it laid before each House of Parliament within the first fifteen sitting days of that House after the report is completed.[23]

The Bill would come into force two years after the day it receives Royal Assent,[24] although there is no particular reason why it should not come into force immediately upon receiving Royal Assent. In fact, it would be in the interest of the entire charitable sector that these changes come into effect as soon as possible after Royal Assent.

D. CONCLUSION

BY REMOVING language from provisions in the ITA that requires charities to carry out their "own activities," the Bill proposes a highly important change to the ITA that would lift an unnecessary burden for Canadian registered charities. As it currently exists, the ITA is still hampered by historical concerns that are no longer justified, given the legal developments over the last several decades.[25] Eliminating the

[21] *Ibid*, cl 2(15).
[22] *Ibid*, cl 6(1).
[23] *Ibid*, cl 6(2).
[24] *Ibid*, cl 7.
[25] Pemsel, *supra* note 9 at 5.

"own activities" test from the ITA would loosen the strict confines of the "direction and control" regime implemented by the CRA. At the same time, the Bill aims at retaining a full measure of accountability by adding an objective standard through language requiring charities to take "reasonable steps" to maintain the use of resources for charitable purposes. While the introduction of the Bill is a welcome and encouraging development, the Bill is in its early stages of review, and charities will therefore want to support as well as monitor the status of the Bill as it makes its way through Parliament.

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