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PRIORITY FOUNDATION FEDERAL COURT OF APPEAL DECISION - U.S. 501(C)(3) TAX-EXEMPT ENTITIES ARE NOT DEEMED TO BE QUALIFIED DONEES

By Theresa L.M. Man*

1. INTRODUCTION

The Federal Court of Appeal, in its decision in *Priority Foundation v. Canada (National Revenue)*[1] on October 7, 2025, held that Article XXI(7) of the *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital, September 26, 1980* [2] ("Tax Convention") does not operate to render U.S. 501(c)(3) tax-exempt entities to be "qualified donees" under the Canadian *Income Tax Act* ("ITA") for the purposes of allowing Canadian registered charities to make disbursements by way of gifts to such entities. The Court dismissed Priority Foundation's ("Priority) appeal of the Canada Revenue Agency's ("CRA") decision to revoke its charitable status for having made gifts to U.S. 501(c)(3) tax-exempt entities and thereby was not operating exclusively for charitable purposes and was not meeting the definition of a charitable foundation.

The decision of the Court provided juridical consideration on the interpretation of Article XXI(7) which has been unclear for many years. As pointed out by the Court, this is not the first time the interpretation of Article XXI(7) of the Tax Convention has been raised in the Federal Court of Appeal ("FCA"), (see *Prescient Foundation v. Canada (National Revenue),*[3] and *Public Television Association of Quebec v. Canada (National Revenue)*[4]). However, in both cases, the FCA resolved the appeals without having to interpret Article XXI(7) on this issue.

2. PROCEEDINGS

Priority was incorporated on August 6, 2008, for the purpose of "disbursing funds and property exclusively to registered charities and qualified donees" under the ITA. In 2008, it was registered as a charity and designated as a public foundation by the CRA. In 2019, it was audited by the CRA for its 2015 to 2017 fiscal years.

Following the audit, the CRA issued an administrative fairness letter dated September 9, 2021, identifying three areas of non-compliance: (1) failure to devote resources to a charitable purpose, including making disbursements by way of gifts to non-qualified donees; (2) failure to meet the disbursement quota; and (3) failure to file an information return when required by the ITA and/or the *Income Tax Regulations*. Non-compliance areas (2) and (3) were related to area (1) in that Priority had included gifts it made to U.S. 501(c)(3) tax-exempt entities (the CRA's position was that they are

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[1] 2025 FCA 180 [*Priority*].
[2] Can. T.S. 1984 No. 15.
[3] 2013 FCA 120.
[4] 2015 FCA 170.

not qualified donees) in the calculation of the disbursement quota and in completing its T3010 *Registered Charity Information Return* for the years under audit.

Although the disbursement quota issue was resolved by Priority having made additional disbursements to other registered charities in its 2019 and 2020 fiscal years, other areas of non-compliance remained outstanding. The CRA issued a notice of intention to revoke its charitable status dated November 10, 2022. Before the expiry of the 90-day period in which Priority may file an objection to the CRA Appeals Branch, charitable status was revoked on January 14, 2023, by a notice published in the Canada Gazette that day. An objection to the CRA Appeals Branch was filed on February 6, 2023. On February 17, 2023, the CRA advised Priority that, based on the CRA's inventory of cases, it would be approximately 6 months before an appeals officer would review the objection.

Priority appealed to the FCA under paragraph 172(3)(a.1) of the ITA from the CRA's failure to confirm or vacate the notice of intention to revoke within 90 days of Priority having served its notice of objection. Priority submitted that the CRA's interpretation of Article XXI(7) of the Tax Convention is wrong in law.

3. ISSUE

There was only one issue before the Court - whether the CRA erred in revoking Priority's charitable registration on the basis that Priority made gifts to non-qualified donees. The determination of this question involved the interpretation of Article XXI(7) of the Tax Convention and its impact on the definition of "qualified donee" in subsection 149.1(1) of the ITA. In other words, the Court had to decide whether Article XXI(7) of the Tax Convention permitted Priority to maintain its eligibility for charitable registration by making gifts to U.S. 501(c)(3) entities.

4. LEGISLATIVE CONTEXT IN THE ITA

For readers who are not familiar with the legislative context in the ITA for registered charities and charitable gifts, a bit of an explanation is needed in order to understand the importance and implications of the Priority decision. This was also briefly explained in the Priority decision by the Court.[5]

- Charitable gifts made by individuals and corporations - Canadian donors who make charitable gifts to qualified donees have certain tax benefits under the ITA. When a corporation makes a charitable gift to a qualified donee, the corporation may claim a deduction of the eligible amount of the gift in computing its taxable income, whereas an individual donor may claim a tax credit in the computation of their tax payable. Eligible charitable gifts that may be claimed in a taxation year are generally limited to a percentage of the donor's net income for that taxation year, and unused charitable gifts may be carried forward for up to 5 years.

- Definition of "qualified donee" - The term "qualified donee" refers to a specific group of entities listed in subsection 149.1(1) of the ITA. Only qualified donees may issue official donation receipts for gifts they receive from individuals and corporations. All qualified donees are exempt from income tax. The definition for "qualified donee" has been amended a few times over the years. For the purposes of the Priority decision, the relevant types of qualified donees defined under audit years in this decision are (a) registered charities, (b) registered universities outside Canada the student body of which ordinarily includes students from Canada, and (c) registered charitable organizations outside Canada to which Her Majesty in right of Canada has made a gift (i.e., registered foreign charities).[6]

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[5] *Priority*, *supra* note 1 at paras 23-31.

[6] Other types of qualified donees during the audit years are registered Canadian amateur athletic associations, registered housing corporations resident in Canada constituted exclusively to provide low-cost housing for the aged, registered Canadian municipalities; registered municipal or public bodies performing a function of government in Canada; Her Majesty in right of Canada, provinces, and territories; and the United Nations and its agencies. Since then, the list of qualified donees was expanded on January 1, 2020, to include registered journalism organizations.

- Meaning of "registered charity" - A "registered charity" (which is one type of qualified donee) is defined in subsection 248(1) of the ITA. It must be resident in Canada, is either created or established in Canada, has applied to the CRA for charitable registration, and is registered by the CRA and designated as a charitable organization, private foundation or public foundation. Registered charities are exempt from paying tax on their income and may issue receipts to donors for gifts they receive. If a registered charity fails to comply with the requirements in the ITA, the CRA may revoke its charitable registration.

- Meaning of "public foundation" - Pursuant to subsection 149.1(1) of the ITA, a public foundation must be a "charitable foundation", which is defined as a corporation or trust that is constituted and operated exclusively for "charitable purposes" and that is not a charitable organization. As a general rule, charitable organizations engage in charitable activities, while charitable foundations raise money for charitable purposes. During the audit period, subsection 149.1(1) of the ITA states that " 'charitable purposes' includes the disbursement of funds to a qualified donee."[7]

Priority is registered by the CRA as a "public foundation." It was incorporated in 2008 for the purpose of "disbursing funds and property exclusively to registered charities and qualified donees" under the ITA.

The Court noted that a foreign charity, such a U.S. 501(c)(3) entity, does not meet the requirement to be a registered charity under the ITA because it is not resident in Canada and is neither created nor established in Canada. Therefore, having regard only to the provisions of the ITA, a gift made by a Canadian taxpayer to a foreign charity is ineligible for tax relief unless the CRA recognizes the foreign charity as a qualified donee, such as a registered foreign university or a registered foreign charity referred to above, or provides relief in some other manner.[8]

This is where cross-border tax relief is provided under the Tax Convention under certain circumstances.

5. INTERPRETATION OF THE TAX CONVENTION

Relief on cross-border charitable giving and exemption from income tax between Canada and the U.S is provided under the Tax Convention. The Tax Convention was signed in September 1980 and enacted into Canadian law by *the Canada-United States Tax Convention Act, 1984*, S.C. 1984, c. 20. It replaced the then existing tax convention between Canada and the United States dating back to 1942. Since its signature in 1980, the Tax Convention has been amended by the adoption of five protocols, the latest of which was signed in September 2007.

In this regard, cross-border charitable giving by Canadian donors to U.S. charities under Article XXI(7) of the Tax Convention, and Article XXI(6) provides reciprocal application to charitable giving by U.S. donors to Canadian charities. For Priority, the interpretation of the wording in Article XXI(7) is at issue: whether this provision deems U.S. 501(c)(3) tax-exempt entities to be "qualified donees" even though they do not meet the definition for "qualified donees" under the ITA. Article XXI(7) states as follows:

> 7. For the purposes of Canadian taxation, gifts by a resident of Canada to an organization that is a resident of the United States, that is generally exempt from United States tax and that could qualify in Canada as a registered charity if it were a resident of Canada and created or established in Canada, shall be treated as gifts to a registered charity; however, no relief from taxation shall be available in any taxation year with respect to such gifts (other than such gifts to a college or university at which the resident or a member of the resident's family is or was enrolled) to the extent

[7] The definition was later amended to " 'charitable purposes' includes making qualifying disbursements" by Bill C-19, Budget Implementation Act, 2022, No. 1, which received Royal Assent on June 23, 2022.
[8] *Priority*, *supra* note 1 at para 30.

> that such relief would exceed the amount of relief that would be available under the Income Tax Act if the only income of the resident for that year were the resident's income arising in the United States. The preceding sentence shall not be interpreted to allow in any taxation year relief from taxation for gifts to registered charities in excess of the amount of relief allowed under the percentage limitations of the laws of Canada in respect of relief for gifts to registered charities. [Emphasis added by the Court in the Priority decision]

The Court noted that the interpretation of the Tax Convention is governed by the *Vienna Convention on the Law of Treaties*[9] ("Vienna Convention") where Article 31 of the Vienna Convention provides the "general rule of interpretation: the Tax Convention shall be interpreted in good faith, in accordance with the ordinary meaning to be given to the terms of the Tax Convention in their context and in light of its object and purpose." The Court further noted the decision of the Supreme Court of Canada in *Alta Energy Luxembourg S.A.R.L*. that "unlike statutes, treaties must be interpreted 'with a view to implementing the true intentions of the parties'."[10] In addition, the Court held that "[t]ax treaties are to be given a liberal interpretation, and literal interpretations should be avoided where the object of the Tax Convention may be defeated."[11]

The Court reviewed the text, context, and purpose of Article XXI(7), noting the principle in *Febles v. Canada (Citizenship and Immigration),*[12] where the key issue in "interpreting a provision of a treaty is the plain meaning of the text …. because it expresses what the parties to it have agreed. The parties to an international convention are not to be treated as having agreed something they did not agree, unless it is clear by necessary implication from the text."[13]

5.1. Ordinary Meaning

Article XXI(7) of the Tax Convention provides tax relief to gifts made by Canadian donors to allow them to claim tax deductions/credits for gifts made to an organization resident of the United States that is generally exempt from U.S. tax. However, the relief has limits – the relief is applicable to U.S. income of the Canadian donor up to the percentage limitations under the ITA for gifts to registered charities. The Court illustrated this with the following example – a Canadian donor who has an overall net income of $1,000 of which $100 is derived from U.S. sources, the Canadian donor can only claim tax deductions/credits up to $75 (i.e., 75% of the donor's US income) pursuant to Article XXI(7).[14]

The parties do not dispute that Article XXI(7) applies to (a) gifts made by Canadian donors to U.S. 501(c)(3) entities, i.e., charitable organizations in the U.S. that are exempted from tax under section 501(c)(3) of the United States' *Internal Revenue Code*; and (b) gifts made by Canadian individuals or corporations.[15]

The issue is the argument by Priority that Article XXI(7) should *also* be interpreted to treat gifts by a Canadian registered charity to U.S. 501(c)(3) entities as gifts to a registered charity, and so to a qualified donee, for the purposes of maintaining Priority's charitable registration.[16]

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[9] Can. T.S. 1980 No. 37.
[10] *Priority*, *supra* note 1, at paras 34-35. *Canada v. Alta Energy Luxembourg S.A.R.L.,* 2021 SCC 49 at para 37.
[11] *Priority*, *supra* note 1, at para 36, referring to the following cases: *Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802 at para. 43; *Levett v. Canada (Attorney General),* 2022 FCA 117 at para 24.
[12] 2014 SCC 68.
[13] [13] *Priority*, *supra* note 1 at para 38, referring to *Febles v. Canada (Citizenship and Immigration),* 2014 SCC 68 at para. 16.
[14] *Ibid* at para. 39-40.
[15] *Ibid* at para 42.
[16] *Ibid* at para 43.

Priority argued that since Priority is a "resident" under the Tax Convention, it can make gifts to US charities and have those gifts be "treated as" gifts to a registered charity "for the purposes of Canadian taxation." Therefore, under Article XXI(7) as applied to a charity (rather than an individual or corporation), gifts constitute qualifying disbursements and are permissible under Canadian tax law, and that it is in line with the fact that Canadian public foundations frequently make gifts to registered charities.[17]

The Court did not agree with Priority's argument.

The Court noted that during the hearing, Priority argued that it was not its position that article XXI(7) of the Tax Convention *deemed* U.S. 501(c)(3) entities to be qualified donees under the ITA, only that the *gifts made to them must be treated* as though they were made to qualified donees for the purposes of Canadian taxation. However, the Court did "not see the purpose of making such a distinction."[18]

The Court pointed out that Priority's charitable registration was revoked on the basis that it did not comply with paragraph 149.1(3)(b) of the ITA where Priority's disbursements must be made to qualified donees to maintain its registration. Therefore, the only way for Priority to successfully argue that the CRA erred in revoking its charitable registration is to demonstrate that Article XXI(7) of the Tax Convention in fact deems U.S. 501(c)(3) entities to be qualified donees.[19]

First, the Court agreed with the CRA's position that there is nothing in the plain wording of Article XXI(7) to support Priority's submission that the first clause of Article XXI(7) can stand alone for the purposes of maintaining its charitable registration and that the qualification that follows it only applies if the resident of Canada is seeking tax relief in respect of such gifts. The semicolon and the word "however" are instrumental. The Court held that the "use of the semicolon at the end of the first clause suggests that what follows is closely related to the first clause" and "the use of the word "however" that follows the semi-colon suggests that it is a qualifier of the first clause and is being used in the sense of "but"".[20]

Second, the Court held that the opening words "For the purposes of Canadian taxation" in Article XXI(7) must be construed with the rest of Article XXI(7), which contains nothing that leads to the conclusion that U.S. 501(c)(3) entities are deemed to be qualified donees for the purposes of maintaining one's charitable registration. The Court held that the Article XXI(7) explicitly states that it is "the gift" that is to be treated as a gift to a registered charity, and it does not mean that the gift is in fact a gift to a qualified donee or that the organization to which the gift was made is deemed a registered charity or a qualified donee. Pointing to the French version of the introductory wording of Article XXI(7), "[a]ux fins de l'imposition canadienne" ("[f]or the purposes of Canadian taxation"), the Court held that it reinforces the interpretation that Article XXI(7) relates to the "imposition of taxes" rather than the "maintenance of charitable registration."[21]

Third, the Court found that the words "that could qualify in Canada as a registered charity if it were a resident of Canada" in the first clause of Article XXI(7) support the interpretation that Article XXI(7) does not extend to the requirements for maintaining charitable registration. The Court held that "[t]hese words demonstrate that Canada intended to retain control over the types of organizations that could benefit from the application of the provision. In other words, if the organization could not qualify in Canada as a registered charity, then presumably the deduction or credit would not be allowed."[22]

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[17] *Ibid* at para 51.
[18] *Ibid* at para 49-50.
[19] *Ibid* at para 52.
[20] *Ibid* at para 53.
[21] *Ibid* at para 54.
[22] *Ibid* at para 55.

5.2. Context

The Court reviewed three areas of the context of Article XXI(7) - other provisions of the Tax Convention, history relating to the requirement that disbursements be made to qualified donees, and the broader context of the Canadian charitable taxation scheme.

Firstly, the Court held that the opening words [f]or the purposes of Canadian taxation" in Article XXI(7), and the inverse words, "for the purposes of United States taxation" in Article XXI(6), must be construed in light of the preamble, Article II, Article IV(1) and Article XXI(1) of the Tax Convention - that is to "provide tax relief in respect of gifts made by taxpayers (individuals or corporations) who have income arising in the country in which the recipient charity is resident which income would otherwise be taxed in the taxpayers' country of residence." This does not support Priority's argument that the Tax Convention extends to the requirements Canadian charities must satisfy to maintain their charitable registration. [23]

Priority argued that the wording of the Tax Convention being broader in scope from its 1956 version demonstrates an intention of the two countries to broaden the applicability of Article XXI(7) beyond tax relief. For example, the 1956 version began with the phrase "[i]n the computation of taxable income for any taxation year under the income tax laws of Canada", in contrast with the current version which begins with "[f]or the purposes of Canadian taxation." However, the Court did not agree that the phrase "for the purposes of Canadian taxation" was "intended to be all-encompassing, such that it would impact the requirements for ongoing charitable registration under the ITA for Canadian registered charities."[24]

Secondly, in relation to the history relating to the requirement that disbursements be made to qualified donees, the Court referred to the amendment to the ITA following the settlement with the CRA in an application commenced in the Ontario Superior Court of Justice (The *Wolfe and Millie Goodman Foundation v. The Queen*, court file 08-06199). This interesting case was also referred to by the FCA in *Prescient Foundation v. Canada (National Revenue).*[25]

- In that case, a private foundation sought confirmation that a grant to a foreign charity met the foundation's charitable purposes and therefore counted towards the foundation meeting its disbursement quota. In settling the dispute in August 2000, the CRA conceded that a gift to a foreign charity had a charitable purpose at common law and confirmed that, insofar as its "disbursement quota" was met, the private foundation could make disbursements to non-qualified donees meeting the definition of "charitable" at common law until such time as the ITA could be amended.
- In the appeal, Priority also relied on a letter from the CRA's Rulings Directorate in 1994, which accepted that Article XXI "merely treats a gift to a U.S. charity as a gift to a Canadian registered charity" and submitted that it was "simply asking that the CRA do just that."
- The ITA was eventually amended in response to the Wolfe and Millie Goodman Foundation settlement to allow the CRA to revoke the registration of a charitable organization, a public foundation or a private foundation (subparagraphs 149.1(2)(c)(ii); 149.1(3)(b.1)(ii); and 149.1(4)(b.1)(ii) of the ITA respectively) which made disbursements by way of gift, *other than to a qualified donee*. These changes to the ITA were enacted in 2013 as part of the *Technical Tax Amendments Act*,[26] and were made effective retroactively to gifts made after December 20, 2002.

Thirdly, the Court reviewed the broader context of the Canadian charitable taxation scheme. In this regard, the Court agreed with the CRA's submission that "if Article XXI(7) deemed a U.S. 501(c)(3) entity to be a registered charity and therefore, a qualified donee, under the ITA, the U.S. 501(c)(3)

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[23] *Ibid* at para 67.
[24] *Ibid* para 68.
[25] *Ibid at* paras 70-71,13.
[26] 2012, S.C. 2013, c. 34.

entity would be subject to the record and bookkeeping requirements provided in subsection 230(2) of the ITA." As such, the Court held that "it would be highly unusual that the Minister's powers of revocation … of the ITA would extend to U.S. 501(c)(3) entities."[27]

The Court noted that Article XXI(7) must be read in the context that the ITA already sets out specific instances in the definition of a qualified donee whereby certain foreign charitable entities are considered to be qualified donees, as explained above. This meant that "Canada could not have intended for this provision to deem U.S. 501(c)(3) entities to be qualified donees for the purposes of maintaining a public foundation's charitable registration. The drafters of the Tax Convention could have easily said that for the purposes of Canadian taxation, the organization (U.S. charity) is deemed to be a Canadian registered charity, and so a qualified donee. They did not do so."[28]

The Court also made reference to the amendment definition of "charitable purposes" in section 149.1 of the ITA on June 23, 2022, to replace "includes the disbursement of funds to a qualified donee" with "includes making qualifying disbursements"; while at the same time paragraph 149.1(3)(b.1) of the ITA was also amended to provide that the registration of a public foundation may be revoked if it makes a disbursement, other than a qualifying disbursement. Although the grant making regime was not before the Count in the Priority decision, the Court held that the amendment supports the view that the requirements for maintaining charitable registration in Canada are found in the ITA and not Article XXI(7) of the Tax Convention.[29]

5.3. Purpose

Priority submitted that determining the purpose of a treaty provision requires, first, defining the purpose of the treaty as a whole, and second, defining the purpose and place of the provision within that scheme.

There was no dispute that the overall purpose of the Tax Convention is to facilitate cross-border trade and investment, to provide relief from double taxation and to set out the respective taxing powers of the state parties in the cross-border tax context. The Tax Convention addresses a variety of issues.

Priority argued that the "Tax Convention reflects the confidence that Canada and the United States have in each other's administration of their respective charitable sectors. In other words, Priority argues that article XXI(7) is a deeming provision that the contracting states intended to govern the registered status of charities."[30] The Court disagreed.

The Court reviewed various materials issued by the U.S. relating to the Tax Convention,[31] and concluded that these materials support the interpretation that "it was the intention of Canada and of the United States to provide reciprocal recognition of exemption for religious, scientific, literary, education, or charitable organizations and to provide tax relief for gifts made by a resident of a contracting state to a tax-exempt organization resident of the other contracting state, providing the taxpayer has income in the other contracting state. The Court was not convinced that "the drafters of the Tax Convention envisaged that it would go as far as interfering with each country's authority to determine the statutory requirements a registered charity must meet to maintain its charitable registration. In short, they support the view that the purpose of the treaty was to provide relief from the

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[27] *Priority*, *supra* note 3 at para 72.
[28] *Ibid* at para 75.
[29] *Ibid* at para 76.
[30] *Ibid* at para 80.
[31] The Court reviewed the Technical Explanation prepared by the United States Treasury Department when the Tax Convention was signed that provided guidance on the parties' views of the purpose of Article XXI and in particular, articles XXI(6) and (7) of the Tax Convention. The Court also reviewed "Guidance Notice Relating to Article XXI of the Tax Convention" (Notice 99-47) issued by the U.S. Internal Revenue Service, which took the view that Article XXI of the Tax Convention was "generally [to provide] for deduction of cross-border charitable contributions, and reciprocal recognition of exemption for religious, scientific, literary, educational, or charitable organizations."

imposition of taxes and not to regulate the conditions an organization must satisfy to maintain its charitable registration in the organization's resident state."[32]

The Court observed that beyond the purpose of Article XXI(7), one of the goals of a charitable registration system is to regulate the gifts made to organizations for charitable purposes. Therefore, the requirement that charitable public foundations make gifts to "qualified donees" (or when applicable, to grantee organizations) "enables the government to monitor the destination of funds, with the goal of preventing gifts from being used, for example, for nefarious purposes, such as money laundering and supporting terrorism."[33]

The Court also noted that the ITA has created a statutory scheme to award credits or deductions for charitable gifts to Canadian registered charities and other qualified donees. In relation to gifts made by Canadian residents to tax-exempt organizations that are resident of the United States, tax relief may only be claimed against the Canadian resident's U.S.-source income pursuant to Article XXI(7) of the Tax Convention.

As such, the implication of Priority's argument that all U.S. 501(c)(3) entities are deemed to be qualified donees for the purposes of Priority maintaining its charitable registration, would lead to an unusual result. In this case, a "Canadian resident individual or corporate taxpayer with no U.S. income wishing to donate to a specific U.S. charity to whom Priority made gifts could have circumvented the U.S. income limitation by making the gift to Priority. In doing so, the Canadian resident taxpayer would then have been able to claim a credit or deduction against their Canadian income, thus allowing the taxpayer to do indirectly what they could not do directly within the ordinary meaning of the Article XXI(7). This could not have been the result intended by the contracting states."[34]

6. Lessons Learned

For all of the above reasons, the Court did not agree with Priority's interpretation of Article XXI(7) and found that the CRA properly revoked Priority's charitable registration for having made gifts to non-qualified donees.

The decision of the Court provided clarity on the interpretation of Article XXI(7) which has been unclear for many years. This decision confirms that qualified donee status under the ITA is strictly limited to entities recognized by Canadian law, not by Article XXI(7) of the Tax Convention. Gifts to foreign organizations, including U.S. 501(c)(3) charities, do not qualify as disbursements to qualified donees, unless the recipient is specifically recognized as a qualified donee, or permitted by some other manner in the ITA.

[32] *Priority*, *supra* note 3 at para 82-84.
[33] *Ibid* at para 85.
[34] *Ibid* at para 86.