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**PRIMER ON DONOR ADVISED
FUNDS AND CURRENT ISSUES**

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A. Introduction

The topic of donor advised funds (“DAFs”) has generated a considerable amount of attention in the past few years, receiving both praise as well as criticism. While some of this criticism may warrant further review and consideration, many of the concerns regarding DAFs, particularly here in Canada, are either unfounded or exaggerated.

Generally speaking, DAFs that are properly set up and operated correctly can be a very helpful means to facilitate gifts for the charitable sector, and one of the options that a charity should consider having in its planned giving “tool kit”. DAFs are flexible and can be structured to work well for the parties involved: the donors, the recipient charities holding them, as well as other registered charities which are the ultimate recipients of gifts from DAFs. It is for these reasons, among others, that the use of DAFS within the charitable sector has grown significantly over the last 20 years in Canada.

However, there are misconceptions about what DAFs actually are at law, the legal requirements when establishing and administering a DAF within a charity, as well as how much ongoing input and control a donor can have in relation to a DAF. In order to be legally valid, DAFs must be properly established, held, maintained, and then utilized on an ongoing basis by recipient charities in compliance with both trust and tax law. Failure to do so could result in a DAF being determined to be invalid which, in turn, could potentially erode donor confidence, expose the recipient charity of the DAF to potential liability, and undermine the recipient charity’s credibility as well as that of the larger charitable sector.

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This paper will address the history, development and current extent of DAFs; identify the various parties involved in DAFs today; review and examine the key legal aspects of establishing and functionally operating DAFs; provide an overview of the current issues associated with these funds; as well as equip the reader with some practical advice when advising clients, whether charity recipients or donors, on the establishment of DAFs and their ongoing operation.

B. History, Development and Current Size of DAFs

1. What is a DAF Anyway?

While all of the legal foundational elements of DAFs are discussed later in this paper, it is important to review at the outset the basics of a DAF. In broad terms, a DAF is a type of charitable giving vehicle that is established when a fund is created by a donor through an initial donation of capital to a registered charity in accordance with the *Income Tax Act* (Canada)¹ (“ITA”).² The registered charity in question is usually a charitable foundation (either a public foundation or a private foundation),³ although DAFs can also be established with a charitable organization⁴ (hereinafter a recipient registered charity of a DAF will be referred to as a “DAF charity”). The gift (and any subsequent gifts) by the donor to the DAF held by the DAF charity is irrevocable, and the donor receives a charitable donation receipt from the DAF charity in exchange for each gift. Donations to DAFs can be cash, securities or other investments, insurance proceeds, or bequests. The income generated by the capital in a DAF is then gifted, either outright or over a period of time, by the DAF charity to qualified donees,⁵ with most gifts usually being made to registered charities.

¹ *Income Tax Act* (Canada), RSC, 1985, c 1 (5th Supp) [ITA].

² There are three types of registered charities under the *Income Tax Act* (Canada), namely charitable organizations, public foundations and private foundations. The designation of a charity depends primarily on its structure, its source of funding and the mode of operation. For more information, see Canada Revenue Agency, “Types of registered charities (designations)”, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/applying-registration/types-registered-charities-designations.html>>.

³ See ITA, *ibid*, s 149.1(1) for the definition of “charitable foundations”.

⁴ See ITA, *ibid*, s 149.1(1) for the definition of “charitable organizations”.

⁵ See ITA, *ibid*, s 149.1(6)(b) for the definition of “qualified donee”. See also Canada Revenue Agency, *CG-010, Qualified Donees*, online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/qualified-donees.html> [CG-010].

In a DAF, the donor is given the unique role of being able to periodically make non-binding recommendations to the DAF charity concerning the distribution of assets from the DAF over to other registered charities. This consultation process between the DAF charity and the donor usually takes place annually, although it can be more frequently. However, despite the donor's ability to provide advice, all administrative, operational, and governance matters of a DAF, including compliance with the ITA and policies of the Canada Revenue Agency, Charities Directorate ("CRA"), are the sole responsibility of the DAF charity. This is because the DAFs are the property of the DAF charity alone, not the donor.

Although DAF charities have fully vested ownership of the DAFs, they will generally follow the advice received from the donor advisors of the DAFs. This relationship of trust between the donor and DAF charity is a key feature of this particular charitable giving vehicle. However, because the DAFs are the legal assets of the DAF charity, it is the DAF charity, and not the donor, that is ultimately responsible for making decisions on how to manage, invest, and administer each DAF.⁶ It is very important that all parties involved in DAFs completely understand how DAFs work, both legally and functionally, at the outset so that there are no unexpected problems or challenges in the future.

2. History, Development and Current Size of DAFs

Community foundations have played an instrumental role in the development of DAFs over the years, both in Canada as well as the United States. The first DAF in the United States was established by the New York Community Trust for William Barstow in 1931.⁷ In Canada, the first DAF was established in the Vancouver Foundation in 1952 by Whitford J. Van Duisen, one of the Foundation's founders and its first chairman.⁸

⁶ Arthur BC Drache, *When Donor Advice is Not Taken*, (24 February 2017) online: Drache Aptowitz LLP <<https://drache.ca/articles/when-donor-advice-is-not-taken/>>, citing a *Non-Profit Quarterly* article, describes two separate situations where DAF holding foundations refused to honor the donor's advice on charities to receive gifts because of the applicable foundation board's political views. The *Non-Profit Quarterly* article noted that the donors in question were considering moving their DAFs as a result, but it is important to note, at least in Canada, that this is not possible at law. While the charity holding the DAF can undertake a change of trustee for a particular DAF to another registered charity, presumably at the donor's request, the decision to do so is that of the charity alone, not the donor.

⁷ Joanna Florino, "Gifting Made Easy", *Philanthropy Magazine*, philanthropyroundtable.org, June 2015, online: <https://www.philanthropyroundtable.org/philanthropy-magazine/article/spring-2015-giving-made-easy>.

⁸ Imagine Canada, "Donor Advised Funds: What Fundraisers Should Know" (6 March 2014) online: <<http://www.imaginecanada.ca/blog/donor-advised-funds-what-fundraisers-should-know>>.

The development of DAFs has expanded correspondingly with the growth in both the number and size of community foundations across Canada and the United States. There are currently 191 local community foundations in Canada holding total assets of approximately \$5.8 billion, and 90% of Canadian communities now have access to a community foundation.⁹ Community foundations hold slightly over half of the DAFs in Canada, with their total DAF assets amounting to approximately \$1.7 billion as of 2016.¹⁰ For comparison purposes, there were 795 community foundations in the United States, holding approximately \$84 billion US in total assets as of 2015.¹¹ Of these assets held by US community foundations in 2015, approximately \$27.83 billion US were attributed to DAFs, which was 36% of the total DAF assets in the United States at that time.¹²

A significant event in the development of DAFs was the establishment of the Fidelity Charitable Gift Fund in 1991 by Fidelity Investments. This was the start of financial services firms becoming involved in DAFs, which had up to then been largely the domain of community foundations. The growth of DAFs since then has been significant, particularly in the United States. Currently, Fidelity Charitable is the largest charity in the United States, surpassing all other charities in contributions received by more than 20 percent, with six of the top 10 fundraising charities being DAF “sponsors”.¹³ As of the year ending June 30, 2017, the value of the 93,521 DAFs held by Fidelity was approximately \$21.1 billion USD.¹⁴ Across the United States, in 2017, charitable assets in DAFs totalled \$110.01 billion, a 27.3% increase from the

⁹ Community Foundations of Canada, “About CFC”, online: <<https://www.communityfoundations.ca/about/>>.

¹⁰ See remarks by Keith Sjogren, Managing Director, Strategic Insight, to the Special Senate Committee on the Charitable Sector (18 September 2018), online: <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/06ev-54210-e>>.

¹¹ Council on Foundations, “Community Foundations”, online: <<https://www.cof.org/foundation-type/community-foundations-taxonomy>>; See also Foundation Centre, “Foundation Stats”, online: <<http://data.foundationcenter.org/#/foundations/community/nationwide/total/list/2015>>.

¹² National Philanthropic Trust, *The 2018 DAF Report*, online: <<https://www.nptrust.org/reports/daf-report/>>. As of 2017, total DAF assets held by US community foundations totalled \$38.61 billion.

¹³ Chuck Collings, Helen Flannery & Josh Hoxie, “Warehousing Wealth: Donor-Advised Charity Funds Sequestering Billions in the Face of Growing Inequality” (July 2018), online: Institute for Policy Studies <<https://ips-dc.org/wp-content/uploads/2018/07/Warehousing-Wealth-IPS-Report-1.pdf>> at 8 [Collings, Flannery & Hoxing]. Please note that this report references a number of more recent articles and papers in relation to the issue of DAFs in the United States, which may be of interest to the reader. See also testimony of Ray Madoff, Professor, Law School, Boston College, to the Special Senate Committee on the Charitable Sector, (24 September 2018) online: <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/07ev-54228-e>> [Madoff].

¹⁴ Fidelity Charitable, *2017 Annual Report*, online: <<https://www.fidelitycharitable.org/docs/2017-Annual-Report.pdf>> at 25.

\$86.45 billion number from 2016, were held in 463,622 separate DAFs, the number of which accounts also increased significantly from 289,478 DAFs in 2016.¹⁵

By comparison in Canada, in 2004, financial services firms started becoming involved in the establishment of affiliated foundations focused on holding DAFs, with the first one being the Private Giving Foundation by the Toronto Dominion Bank.¹⁶ The recent growth of DAFs in Canada has been largely attributed to the 2006 and 2007 ITA amendments, as well as the changing demographics of wealth.¹⁷ In this regard, the 2006 ITA amendments completely eliminated capital gains tax on donations of publicly-traded securities to charitable organizations and public foundations made after May 1, 2006.¹⁸ The ITA was further amended in 2007 to permit private foundations to also receive these types of donations, effective as of March 19, 2007.¹⁹ As a result of these changes, individuals holding publicly-traded securities were incentivized to make gifts to the charitable sector in order to benefit society, as well as receive considerable tax benefits in exchange.

The changes to the ITA led to, among other things, the establishment in Canada of a number of dedicated public and private foundations whose sole purpose is to hold DAFs.²⁰ These foundations, which include those associated with financial services institutions and firms, were estimated to hold \$1.5 billion CAD in assets as of the end of 2016.²¹ Combined with the value of DAFs currently held by Canadian community foundations, there are approximately 10,700 DAFs in Canada with a total value of approximately \$3.2 billion CAD.²²

It is estimated that, in 2016, there were 5,500 private foundations in Canada holding a total of \$41 billion CAD in assets, with an average asset size of \$7.4 million CAD for each private

¹⁵ *Supra* note 12 at 17.

¹⁶ Keith Sjogren, “Donor-Advised Funds Attracting Attention” (12 June 2018), online: Strategic Insight <<https://www.strategic-i.com/blog/donor-advised-funds-attracting-attention/>>.

¹⁷ *Supra* note 10.

¹⁸ Karen J Cooper and Terrance S Carter, *Charity Law Bulletin No. 113*, “Budget 2006: Elimination of Capital Gains Tax on Certain Gifts” (30 May 2006), online: Carters Professional Corporation <<http://www.carters.ca/pub/bulletin/charity/2006/chylb94.htm>>.

¹⁹ Karen J Cooper and Terrance S Carter, *Charity Law Bulletin No. 113*, “Federal Budget 2017: Highlights for Charities”, (29 March 2007), online: Carters Professional Corporation <<http://www.carters.ca/pub/bulletin/charity/2007/chylb113.pdf>>.

²⁰ *Supra* note 10.

²¹ *Ibid.*

²² *Ibid.*

foundation.²³ In the same year, there were approximately 10,000 DAFs in Canada (holding total assets of approximately \$3.2 billion CAD) with an average individual size of \$300,000 CAD.²⁴ By contrast, in 2016, the number of DAFs in the United States were considerably larger than Canada, with approximately \$86.45 billion USD in total assets (approximately 30x larger, once the CAD-USD exchange rate is factored in) held in approximately 289,500 DAFs.²⁵ Interestingly, in 2016, the average asset size of each American DAF was also approximately \$300,000 USD.²⁶

In terms of the future, DAFs are expected to continue growing in popularity. The reasons cited for this include the anticipated creation and ownership of wealth in Canada, the projected significant transfer of wealth in the next 20 years, and the growing popularity of “retail philanthropy” by foundations affiliated with financial institutions as well as community foundations. Given these trends, DAF assets are projected to possibly reach \$7.5 billion CAD in Canada by the end of 2023.²⁷

3. Who are the Key “Players” in DAFs?

There are several parties with a role and/or interest in DAFs. While the immediate ones who come to mind are the donors and the DAF charities (often called “sponsors”), there are other participants as well in the establishment, management and administration of DAFs. These include registered charities, the CRA as the regulator of all registered charities and financial advisors. This paper will briefly review each of these DAFs participants and their role in the process.

a) Donors

Donors in Canada have a number of different ways that they can engage in making gifts to registered charities, from outright gifts, use restricted gifts, time restricted gifts such as

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Supra* note 12 at 16-17.

²⁶ *Ibid* at 19. This Report indicated that in 2017, the average DAF account size in the United States declined to \$237,280, a 20.5% decrease. This appears to be attributed to an increase in the number of individual DAFs with less than \$5,000.

²⁷ *Supra* note 10.

endowments and bequests, to name just a few. There are various factors which play a role in a donor deciding which charitable giving method is best for them, including, but not limited to, the source of funding for a gift, its size, timing considerations and whether the donor has decided on the type of charity(ies) that he/she would like to support.²⁸ It is generally thought that the growing attraction of DAFs to donors is their desire for ongoing control, or at least input, over the application of the assets held in the DAF for charitable purposes. However, whether donors attain this level of control or not, legally or functionally, will be reviewed later in this paper.

Another consideration for donors to be aware of in relation to DAFs is that, once a DAF is established, it cannot be used by a donor to fulfill pledge obligations that he/she subsequently makes to registered charities.²⁹ This is because the gift(s) that the donor has already made to the DAF is irrevocable and is now the property of the DAF charity. While the donor can certainly provide advice to the DAF charity on which specific registered charities he/she would like gifts to be made to, the final decision to do so is that of the DAF charity.

b) Recipient Charities of DAFs

DAFs are able to be established in a variety of registered charities, including community foundations, in-house foundations established by financial institutions, charities specifically established to hold DAFs, as well as more traditional charities, such as religious denominations, national organizations, parallel foundations and the like.

Generally speaking and subject to their own specific charitable purposes, community foundations are focused on raising monies from donors in a particular geographical community, *e.g.* a city or a region/county, and then expending those monies for local causes and registered charities located in the same geographical area. As explained above, community foundations in Canada are currently the biggest holders of DAFs.

²⁸ *Ibid.*

²⁹ Baker Tilly, “Insights: Pledges and Donor Advised Funds Don’t Mix” (11 September 2014), online: <<https://bakertilly.com/insights/pledges-and-donor-advised-funds-dont-mix/>>.

However, over the past two decades, many financial institutions have established their own “captive” in-house foundations to enable their own financial advisors to offer DAFs and related advisory services to their own clients.³⁰ In Canada, these financial institutions include large banks (*e.g.* TD Bank and the Bank of Nova Scotia), credit unions (*e.g.* Vancouver City Savings Credit Union) as well as mutual funds and financial services firms (*e.g.* MacKenzie Investments, Investors Group, Nicola Wealth Management, and Raymond James Canada).³¹

In addition, there are other large financial institutions and wealth management firms who have not established affiliated charitable foundations but instead have established partnerships with independent foundations in order to offer DAFs and related advisory services to their clientele. Examples of these include BenefAction Foundation (working with CIBC Private Wealth Management and Assante Management), Charitable Gift Funds Canada Foundation (working with RBC Dominion Securities and the Bank of Montreal) and Aqueduct Foundation (working with Scotiabank).³² These two types of foundations affiliated with financial institutions will be collectively referred to in this party as “in-house foundations”.

Generally, the financial firms who utilize these in-house foundations approach DAFs as vehicles through which their clients are able, as part of their own personal wealth management, on which the financial institution provides advice, to achieve their personal and financial objects. While these in-house foundations hold and administer the DAFs, they utilize the investment services of their related financial institutions to do so, resulting in management and investment fees remaining within the financial institution “family”.³³

³⁰ *Supra* note 13, at 7.

³¹ Keith Sjogren & Carol Bezaire, “Help Canadians Give: Donor-Advised Funds as a Philanthropic Strategy” (28 March 2018), online: MacKenzie Investments <<https://www.mackenzieinvestments.com/en/products/charitable-giving-program/help-canadians-give>> at 6.

³² *Ibid.*

³³ James Andreoni, *The Benefits and Costs of Donor Advised Funds* (paper presented at the Tax Policy and the Economy Conference, Washington, DC, 29 October 2017), online: <<https://inequality.stanford.edu/sites/default/files/Andreoni-paper.pdf>>.

Currently, the biggest in-house foundations in Canada are: Charitable Gift Funds Canada Foundation (RBC Dominion Securities and the Bank of Montreal), Private Giving Foundation (TD), Strategic Charitable Giving Foundation (MacKenzie Investments and Investors Group), Aqueduct Foundation (Scotiabank), BenefAction Foundation (CIBC), NWM Private Giving Foundation (Nicola Wealth Management) and Vancity Community Foundation (Vancouver City Savings Credit Union).³⁴ Total assets held by the 18 in-house foundations in Canada were approximately \$1.5 billion at the end of 2016, with the top 10 in house foundation holding approximately 95% of these assets.³⁵

More recently, there has been an increasing number of independent registered charities established for the sole purpose of offering DAFs or raising monies from the community to then gift over to other registered charities (which will be collectively referred to as “independent DAF charities”). Generally speaking, these independent DAF charities are either public or private foundations which are not directly connected with either a community foundation, a financial institution or another registered charity. That said, these independent DAF charities are able to establish partnership arrangements with both financial services firms and/or registered charities which do not have their own parallel foundation or interest/ability to administer DAFs themselves, as well as sometimes a for-profit operating company to provide technical, administrative and managerial services. Some of the current leading independent DAF charities in Canada include Tides Canada, Charitable Impact Foundation (Canada) (known as CHIMP) and Canada Gives.³⁶ These three independent DAF charities collectively held total assets of \$146.6 million at the end of 2016.³⁷

Another variation is single issue focused charities established to receive and hold DAFs for the benefit of their particular sector. While more common in the United States than Canada, these types of independent DAF charities have been established to receive and administer DAFs for the benefit of various religious organizations, higher education facilities, hospitals, *etc.* One example is the SickKids Charitable Giving Fund, which is affiliated with the

³⁴ *Supra* note 31.

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ *Ibid.*

SickKids Foundation but is not a dedicated sub-parallel foundation to it.³⁸ This is because, depending on a donor's wishes, the DAFs established within the SickKids Charitable Giving Fund are not required to be exclusively for the benefit of the SickKids Foundation or the SickKids Hospital itself.

While not as common, it is also possible for regular registered charities to offer DAFs as a structured giving option to their donors.

c) Registered Charities Receiving Gifts from DAFs

The gifts to be made from the income and/or capital of a DAF, as applicable, are required to be given to qualified donees in accordance with the ITA.³⁹ Usually on an annual basis, the DAF charity will consult with the applicable donors to each DAF and seek their advice on the recipient qualified donees, which are usually registered charities, to receive gifts from the DAF in the applicable year. The final decisions, though, on the approved gift recipients are those of the DAF charity itself, as the owner of the DAFs.

Given the location of DAFs within DAF charities, it presumably has been challenging for registered charities to apply for grants directly from DAFs, something which registered charities have traditionally been able to do with public or private foundations. Given the significant growth in DAFs over the last 15 years, this presumably is a potential source of concern to registered charities which are constantly in search of new donations from past and current donors, as well as attracting new donors. However, this appears to be changing with some DAF charities, such as Canada Gives, now developing grant application systems whereby registered charities can submit applications for consideration for grants by DAFs.⁴⁰

³⁸ Sick Kids Foundation, "Donor Advised Funds" online:

<<https://www.sickkidsfoundation.com/waystodonate/majorgiftsendowmentsandfoundations/donoradvisedfunds>>.

³⁹ CG-010, *supra* note 5. Under the ITA, qualified donees are organizations that can issue official donation receipts for gifts that they receive from individuals and corporation. They can also receive gifts from registered charities but do not need to issue a donation receipt in exchange for the gift.

⁴⁰ See, for example, Canada Gives, "About Canada Gives", online: <<http://www.canadagives.ca/about-us/about-canada-gives/>> and Canada Gives, "Grant Applications from Charities", online: <<http://www.canadagives.ca/giving-to-charities/giving-to-canadian-charities/grant-applications-from-charities/>>.

d) The CRA

All DAF charities are required to be registered charities in accordance with the ITA. As indicated earlier in this paper, they are usually either public foundations or private foundations. As registered charities, DAF charities are regulated by the CRA and must be in compliance with all of the applicable requirements of the ITA, as well as all applicable CRA policies for registered charities.

e) Others, *e.g.* Financial Advisors

One key factor in the growth of DAFs within the financial sector is the role of financial advisors in becoming involved in advising their clients on the philanthropy options available to them, including the use of DAFs. Generally speaking, clients who are interested in establishing DAFs will often take the advice of their financial advisors on which charitable foundation should be utilized to set up their DAFs. Where this occurs, the financial advisor may receive a bonus from the DAF charity for the initial client referral, as well as potential future bonuses based on the ongoing amount of the assets held in the DAF.⁴¹ By contrast, where a financial advisor has a client who establishes a DAF with a non-financial services related DAF charity, such as a community foundation, then there presumably is less ability for the financial advisor to receive such bonuses.

4. Why are DAFs so popular now?

There has been a growing desire for more and more donor control over their charitable donations, and this has been a growing trend for at least the last 20 years.⁴² In this regard, DAFs are often described as a practical and appealing alternative for donors who do not have the ability, interest, or time to operate their own private family foundations, yet have an interest in providing input with respect to how these funds are expended. As previously discussed, a DAF does not require the donor to be involved in the burdensome task of establishing and then

⁴¹ Collings, Flannery & Hoxing, *supra* note 13 at 30-31.

⁴² Charlotte Cloutier, "Donor-Advised Funds in the U.S.: Controversy and Debate" (1 September 2004) 19:2 *The Philanthropist*, online: <<https://thephilanthropist.ca/2004/09/donor-advised-funds-in-the-u-s-controversy-and-debate/>>.

operating their own private foundation, which has been the traditional vehicle by which families with considerable wealth conducted their philanthropy.

Instead, donors of DAFs can maintain an ongoing advisory role in relation to the DAF, while all administrative, operating and governance matters are decided by the DAF charity.⁴³ Functionally though, there is the perception, rightly or wrongly, that donors actually have *de facto* control over the utilization of the assets held in their DAFs for charitable purposes. This issue of what a DAF can be, both legally and functionally, will be reviewed in more detail later in this paper.

It is also relatively inexpensive for donors to establish a DAF in comparison to establishing a private foundation, which means that DAFs can be utilized by a greater number of potential donors in comparison to those capable of setting up private foundations. The donor can establish a DAF with a DAF charity, usually a community foundation or a charitable foundation affiliated with a financial institution, through a minimum initial donation amount. While this minimum initial donation amount can vary from charity to charity, it can be as low as \$5,000.⁴⁴ A recent survey of DAF charities found a wide range of minimum initial donation requirements to establish a DAF, which varied from \$0 to \$250,000.⁴⁵ A donor wishing to establish his or her own private family foundation, by contrast, needs a significantly larger capital amount.

Another reason for the popularity of DAFs is because of the perception on the part of donors that they can remain anonymous while providing advice to the DAF charity on its distribution of gifts to qualified donees, usually registered charities. Since it is the DAF charity that provides the gifts to the registered charities, the recipient charities could receive a gift without being advised of the DAF donor's identity. In so doing, donors utilizing DAFs for this purpose do not

⁴³ *Supra* note 8.

⁴⁴ *Ibid.*

⁴⁵ Keith Sjorgen, Katherine Dalziel and Karen Hudson, "Donor Advised Funds: What's Ahead?" (PowerPoint Presentation to the Canadian Association of Gift Planners, April 12, 2019) at slide 9. In this slide, the minimum initial donation varied as followed: \$0 at CHIMP, \$10,000 TD Private Giving Foundation, \$25,000 at Benefaction Foundation, \$100,000 at SickKids Foundation and \$250,000 at Aquaduct Foundation (Scotiabank).

need to be concerned about ongoing solicitations for donations from these recipient charities, which is normally the case after a donor makes a direct gift to a registered charity⁴⁶.

C. What is a DAF at Law?

A DAF is, in general terms, a common type of restricted charitable purpose trust, also known as a donor restricted charitable gift. If a charity accepts a gift subject to a restricted charitable purpose trust, then it is legally bound to comply with those restrictions and fully understand the implications of not doing so. This requires a charity to fully understand the various “layers” associated with such a donor restricted charitable gift, including the basic attributes of a charitable gift, the impact of when donor restrictions are imposed on a charitable gift, as well as the applicable tax law governing such gifts. Accordingly, this section provides a brief discussion of these legal components of a DAF.

1. What is a Charitable Gift?

The first question to be examined is what constitutes a gift? According to Black’s Law Dictionary, the standard definition of a gift in law is the following:

*Gift – the voluntary transfer of property to another without compensation.*⁴⁷

Under the common law, the Federal Court of Appeal has defined a gift as a “voluntary transfer of property owned by the donor to a donee, in return for which no benefit of consideration flows to the donor.”⁴⁸ There are two main types of gifts under the common law: *donatio mortis causa* (gifts made in prospect of death) and gifts *inter vivos* (gifts made during one’s lifetime).⁴⁹ This paper focuses on *inter vivos* gifts.

⁴⁶ *Supra* note 31 at 6.

⁴⁷ Brian A Garner et al, eds, *Black’s Law Dictionary, Ninth Edition*, (St Paul, MN: Thomson Reuters, 2009) sub verbo “gift”.

⁴⁸ *Friedberg v R.* (1991) 92 DTC 6031 (Fed CA), affirmed [1993] 4 SCR 285.

⁴⁹ Department of Justice, “The Concept of a Gift/Don Comparative Study – Civil Law Common Law Tax Law”, online: Government of Canada <<https://www.justice.gc.ca/eng/rp-pr/csj-sjc/harmonization/siroi/gift3-don.html>> [Concept of a Gift/Don]. See particularly n 62. For further information, see also Kathryn Chan, “The Perils of Federalizing the Common Law: A Case Study of the *ITA* Gift Concept” (2017) 50 *UBCL Rev* 579 at 585 [Chan].

There are three conditions, under the common law, which must be met for an *inter vivos* gift to be valid: 1) the gift must be voluntary; 2) there must be a transfer of property, and 3) the donor cannot receive any consideration for making the gift.

First, in order for a gift to be made voluntarily, the donor must actually intend to make a gift. Given this, the donor must have a clear intent to make a gift and must have the requisite capacity at law to make the gift, *i.e.* the donor is not acting under duress or is mentally incompetent. Further, the gift must be real or personal property, but cannot be, for example, services rendered. Finally, the donor cannot be under any legal obligation or coercion to make the gift, such as being compelled by court order or a contract to make the gift in the first place, or it will be invalid.

Second, the property to be gifted must actually be transferred or delivered to the intended recipient by the donor, with evidence of the said delivery or transfer and subsequent acceptance by the donee. The best way to evidence such delivery or transfer, together with acceptance, is through a deed of gift or similar documentation signed by the parties. However, depending on the nature of the gifted property, other actions may be required to complete the delivery or transfer, such as registering securities or title to real property in the name of the donee or physically delivering a tangible asset, such as artwork or a piece of equipment. Even delivery of straightforward cash gifts should be evidenced, *e.g.* through a cheque which is presented for payment and cashed by the applicable financial institution.⁵⁰ Generally speaking, this acceptance of a gift by the donee or recipient charity is presumed upon the delivery of the property that is the subject matter of the gift by the donor to the donee.⁵¹

Third, since a gift must be gratuitous, the donor cannot receive any consideration for the transfer of property.⁵² Accordingly, it is important to ensure that the donor does not retain control or

⁵⁰ See, for example, *Ampomah v The Queen*, 2014 TCC 217; *McCalla v The Queen*, 2014 TCC 199; *Akinbo v The Queen*, 2014 TCC 214; and *Imoh v The Queen*, 2014 TCC 258. See also Terrance S Carter and Theresa LM Man, “When is a Gift Not a Gift? And What to Do when Gifts Go Bad?” (Carters/Fasken Martineau Healthcare Philanthropy Check-Up 2016), online: Carters Professional Corporation <<http://www.carters.ca/pub/seminar/charity/2016/Handout-When-is-a-Gift-Not-a-Gift.pdf>> at slide 17 [Carter and Man].

⁵¹ *Supra* note 49.

⁵² It is important to be aware that this common law requirement for a gift has been overridden by the split receipting rules under the ITA, which will be discussed in section C3 of this paper.

possession of the gift once it is given to the intended recipient.⁵³ This means that the donor must fully “divest” himself/herself of all interest in and therefore rights with respect to the donated property. Excessive on-going control by the donor over the gifted property may defeat or negate the gift. As such, any input provided by the donor over the use or management of a DAF must be completely non-binding, as a donor who is given too much input or control over a DAF would likely be viewed as having *de facto* control over the fund, which would disqualify the donations to the fund from being considered a true gift at law. This disqualification of a gift has serious potential implications under tax law, which will be reviewed later in this paper.

2. What is a Donor Restricted Charitable Gift?

The next question to review is whether a charitable gift is unrestricted or restricted. An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose that is not subject to any restrictions imposed either directly or indirectly by the donor, other than the requirement that the gift be used for the charitable purpose of the recipient charity.⁵⁴ This means that, provided the gift is used within the parameters of the applicable charitable purposes, the recipient charity is able to use the gift at its absolute discretion. This could then result in the recipient charity disbursing some or all of the gift or not utilizing it at all in the short term, investing the gift for the short term or even in perpetuity, as well as using the gift (or the income from it if invested) for any one of its authorized charitable purposes.

By contrast, a restricted charitable gift is, just that, restricted. Black’s Law Dictionary defines the term “restriction” as follows:

*Restriction - 1. A limitation or qualification. 2. A limitation (esp. in a deed) placed on the use or enjoyment of property.*⁵⁵

⁵³ DWM Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984) at 153.

⁵⁴ Terrance S. Carter, “Donor-Restricted Charitable Gifts: A Practical Overview Revisited II” (Paper presented for the Canadian Association of Gift Planners at the 2006 Annual National Conference, 2006), online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>> at 9.

⁵⁵ *Supra* note 47, sub verbo “restriction”.

A donor restricted charitable gift is generally described as “a gift at law to a charitable purpose that is subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would constrain or limit a charity concerning how the gift can be used”.⁵⁶

Where a charity receives a donor-restricted charitable gift, then its board must be careful to identify the nature of the donor restrictions, recognize the legal consequences of the specific type of restriction imposed by the donor, as well as the importance of ensuring compliance with the applicable restriction. This is because the main duty of directors or trustees of a charity is to carry out its charitable purposes in accordance with the applicable restrictions set out in donor restricted charitable gifts⁵⁷. Failure by a charity to identify, understand, and comply with donor restrictions on gifts will potentially expose the charity, as well as its board of directors, to potential breach of trust allegations.⁵⁸

There are different types of donor restricted charitable gifts, with each one giving rise to distinct legal consequences. One key type of donor restricted charitable gift is the special purpose charitable trust, which are gifts held by a charity in trust for a specific charitable purpose which falls within the broader parameters of the charity’s general charitable purposes. In practice, a special purpose charitable trust is established when the donor has expressed an intention that the property being given to the charity is to be held for a specific charitable purpose. These donor-imposed purposes could involve: (1) a time restriction, *e.g.* the capital of the gift to be held for perpetuity or another set period of time; (2) a use restriction, *e.g.* where the gift is to be used for a specific charitable purpose such as constructing a building or research into a particular disease; or (3) both a time and use restriction, *e.g.* an endowment with the capital to be held in perpetuity and the income only to be used for a specific charitable purpose.⁵⁹

⁵⁶ *Supra* note 54 at 11.

⁵⁷ Tudor on Charities, 8th ed., Jean Warburton and Deborah Morris (London: Sweet and Maxwell, 1995) at 191

⁵⁸ See *supra* note 54 at 52-54 for examples of situations where the courts have found that a breach of trust by directors or trustees has occurred for failing to follow the terms of a donor-restricted charitable gift.

⁵⁹ *Ibid* at 20.

Gifts which are subject to a special purpose charitable trust are held by the charity in trust for the stated special purpose and are not owned beneficially by the charity. This results in the special purpose charitable trust becoming, in essence, a charity within a charity although it is not necessary for it to be registered as a separate charity with the CRA. If a charity holds these types of gifts, then it can only use the gift to accompany the specific charitable purpose established by the donor and for no other purpose. To do otherwise would constitute a potential breach of trust by the charity and its directors.⁶⁰

3. What is a Gift for Income Tax Purposes?

Donors who intend to receive tax benefits for their donations under the ITA need to ensure that their donations are gifts both at common law and under the ITA. While the CRA has adopted the traditional common law definition of a gift, being "a voluntary transfer of property owned by a donor to a donee, which the donee makes without anticipation, expectation or receipt of materials benefit"⁶¹ it is important to be aware that gifts for income tax purposes are not necessarily the same as gifts at common law.

The ITA's definition of property includes property of any kind whatsoever, whether real or personal, and can include cash, real estate, securities, tangible assets like equipment, *etc.*, but does not include services, free accommodation, or free use of real property or a pledge to property which is not yet fulfilled.⁶² Further, unlike the common law definition of gift which requires that the donor does not receive *any* consideration earlier discussed in this paper, the split receipting rules under the ITA permit donors to receive an advantage (*i.e.* consideration or a benefit) in exchange for having made a gift to a recipient charity.⁶³

⁶⁰ *Ibid* at 12.

⁶¹ Chan, *supra* note 49 at 579-580. See also Concept of a Gift/Don, *supra* note 49 and Canada Revenue Agency, *P-113 – Gifts and Income Tax 2018*, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p113/p113-gifts-income-tax-2016.html>> [P-113].

⁶² Canada Revenue Agency, "What is a gift?" online: Government of Canada <<http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/gfts/whtseng.html>>. See also the definition of "property" in the Charities and Giving Glossary, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/charities-giving-glossary.html#prprty>>.

⁶³ P-113, *supra* note 61.

In this regard, only gifts that meet the requirements in the ITA can be properly receipted by a recipient charity. Charities are required to ensure compliance with all ITA rules, including that donation receipts are legitimately and properly issued for gifts. Where a charity has engaged in improper receipting of gifts, then this may lead to both CRA sanctions and penalties⁶⁴ or even revocation of a charity's charitable registration which, in turn, would result in the charity's directors and senior management being designated as ineligible individuals under the ITA.⁶⁵ Such a designation can seriously impact the reputation of board members/officers and the future employability of a charity's senior management.⁶⁶

In relation to donors, if a charity has to return improper gifts to a donor, this will negatively impact its donor relations as well as generate bad press for the charity in the public domain.⁶⁷ However, in most cases, it is not possible for a registered charity to return a donor's gift. This is because, at law, a gift transfers ownership of the gifted property from the donor to the charity. Once the transfer is made, the gifted property belongs to the charity and it is obliged to use the gift in carrying out its charitable purposes⁶⁸.

A registered charity that issued an official donation receipt and later returns donated property to the donor must file an information return with the CRA within 90 days after the day the property is returned, as well as provide the donor with a copy of the said information return⁶⁹. Further, if a gift is found by the CRA to fail, then the CRA will reassess the donor's income tax returns that relied on the donation receipts issued for the said invalid gifts.⁷⁰ This would likely lead to

⁶⁴ Canada Revenue Agency, Consequences of Improper Receipting, online: <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/issuing-receipts/consequences-improper-receipting.html>>. See also Canada Revenue Agency, Penalties and Sanctions, online: <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/penalties-suspensions.html>>.

⁶⁵ ITA *supra* note 1, s 188.1(7)-(9). See also Canada Revenue Agency, CG-024, *Ineligible Individuals*, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/ineligible-individuals.html>> for more information on Ineligible Individuals.

⁶⁶ *Supra* note 50 at slide 6.

⁶⁷ *Ibid* at slide 4.

⁶⁸ Returning a Gift to a Donor online: Government of Canada, <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/receiving-gifts/returning-a-gift-a-donor.html>.

⁶⁹ Canada Revenue Agency, "CG-016, Qualified donees – Consequences of returning donated property" online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-016-qualified-donees-consequences-returning-donated-property.html>>.

⁷⁰ *Ibid*. Gifts can fail, for example, when a charity receives a restricted purpose gift and the charity's purposes subsequently change or when one of its programs ceases to exist.

not only profound donor disappointment but could also potentially result in the donor seeking compensation from the charity as a result of the reassessment and any associated penalties and interest.

4. How Does This All Relate to a DAF?

A DAF is a distinct fund within the structure of a DAF charity which is established when a donor makes a single gift or, if he/she wishes, a series of irrevocable gifts to the said DAF charity. Others, such as friends and family members of the donor, are also able to make gifts to the DAF, either at the time of its establishment or during its lifetime, to be utilized by the DAF charity in accordance with the terms of the gift agreement between the original donor and the DAF charity establishing the DAF.

The original gift from the donor establishing the DAF could be unrestricted or, alternatively, could be subject to one or more donor restrictions, such as how long the capital is to be held or the income of the fund is to be used by the DAF charity. However, the unique aspect of a DAF is that, in addition to any specific donor restrictions that may (or may not) be impressed upon the gift at its inception, there is, at a minimum, a donor-advised “feature” added to the gift by the donor, providing him/her with ability to be able to offer ongoing advice to the DAF charity on one or more specified aspects of the DAF.⁷¹

This means that the basic characteristic of DAFs, as compared to restricted charitable gifts (such as special purpose charitable trusts described earlier in this paper), is that they do not necessarily have any legally enforceable restrictions associated with them in relation to how the capital or income of the fund is to be distributed other than to seek advice from the donor. Rather, the donor-advised aspect of a DAF will simply permit the donor to express a preference, desire or request to the DAF charity regarding, as set out in the original gift agreement, generally concerning the amount of and who the recipient should be of gifts from the DAF at a future date.

⁷¹ Terrance S Carter, “Considerations in Drafting Restricted Charitable Purpose Trusts” (Paper delivered at The Society of Trust and Estate Practitioners Canada STEP Canada 19th National Conference, 12 June 2017), at 4, online: <<http://www.carters.ca/pub/article/charity/2017/STEP-Drafting-Restricted-Charitable-Purpose-Trusts.pdf>>.

While these donor suggestions do not actually impose a legal obligation upon the DAF charity to accept such suggestions, they do result in considerable practical, as well as moral, expectations being placed upon the DAF charity.⁷² These practical expectations relate to the charity ensuring that it, in fact, takes steps to seek and obtain the donor's advice in accordance with the terms of the original gift agreement, whereas the moral obligations involve the DAF charity considering the donor advice received and presumably generally follow such advice, although the ultimate decision on which qualified donee to make gifts to is that of the DAF charity itself.

The key legal issue for a DAF is that ownership of the fund, and all monies held in it, is by the DAF charity and, as such, the DAF charity must retain and exercise control over all decisions associated with the fund, including investing and distribution. This means that the DAF charity must appropriately advise its donors that their input in relation to the DAF can be of an advisory nature only. This is imperative for the DAF charity to do in order to ensure that the donations being made by the donor to the DAF are true gifts at law and are able to be properly receipted as such under the ITA.⁷³ Where there is excessive on-going control by the donor over the gifted property, the CRA may consider the gift to be defeated or negated,⁷⁴ which means that it cannot be receipted under the ITA.

The gifts to be made from the income and/or capital of a DAF, as applicable, are to be given to qualified donees in accordance with the ITA. The list of the types of organizations which can be qualified donees is long, but one of the key types is registered charities (consisting of charitable organizations, public foundations and private foundations).⁷⁵ Each of these gifts is made from the DAF charity over to the recipient registered charity as a gift from one qualified donee to another qualified donee. The recipient registered charity will not need to include such gifts from the DAF charity as receipted income in their annual charity information returns (T3010s),

⁷² *Ibid* at 34-35.

⁷³ *Ibid* at 36.

⁷⁴ Canada Revenue Agency, "What is a gift?" online: Government of Canada < <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/gfts/whtseng.html> >. It is stated, in relation to directed gifts, that "if the donor retains too much control the donation will no longer be considered to be a gift at law and an official donation receipt cannot be issued."

⁷⁵ CG-010, *supra* note 5.

although the DAF charity will need to list all of its gifts to qualified donees in its own annual T3010.⁷⁶

A common concern raised by recipient registered charities receiving gifts from DAFs is the lack of direct relationship that they have with individual donors. In this regard, the DAF charity serves as an intermediary for these gifts so that the recipient registered charity cannot approach the underlying donor directly to either solicit ongoing gifts or report back on how past gifts have been utilized to achieve the charity's charitable purposes. This lack of direct contact with the donors can cause uncertainty for these recipient registered charities in securing ongoing and consistent revenue streams.

D. Current Issues Associated with DAFs

The purpose of this section of the paper is to canvass some of the current issues that have been raised in the charitable sector, including arising from the work of the Special Senate Committee on the Charitable Sector⁷⁷ ("Senate Committee") in relation to DAFs. It should be noted that this section is not intended to set out an exhaustive list of all possible DAF-related concerns or attempts to address them in any significant way.

That being said, it is hoped that the comments below will serve to show how several of the concerns being expressed about DAFs, particularly here in Canada, are not as serious as is being suggested and/or can be addressed by the common law or under by the existing ITA provisions. To the extent that concerns about DAFs continue to exist, it is hoped that careful study of the issues and any proposed solutions to address such concerns will be undertaken by the CRA and the Department of Finance Canada in order to ensure that the charitable sector is not negatively impacted inadvertently by any solutions that might be proposed, thereby avoiding the application of the old adage of "the cure is worse than disease".

⁷⁶ This is done at line 5050 of the T3010 itself, as well as by the DAF charity completing Form 1236 to the T3010, entitled *Qualified Donees Worksheet/Amounts Provided to Other Organization*.

⁷⁷ Senate Canada, "Special Committee: Charitable Sector (Special)", online: Parliament of Canada <<https://sencanada.ca/en/committees/cssb/>>.

1. Disbursement-Related Issues

One of the key issues being discussed about DAFs is whether there are sufficient distributions being made from individual DAFs by DAF charities through gifts to the larger charitable sector. A related issue is whether the federal government should take steps to require or incentivise distributions from DAFs to qualified donees, specifically registered charities, as well as whether a separate disbursement quota should be introduced for individual DAFs.⁷⁸

The concern here appears to be that while DAFs are receiving an increasing share of the overall charitable donations which are available and donors are receiving immediate tax benefits in exchange for their gifts to DAFs, the DAF charities are simply “sitting on” these DAF assets and not distributing out to the charitable sector in a timely enough manner.⁷⁹ As a result, there is an apprehension that significant assets may be being diverted away by DAFs from the larger charitable sector.⁸⁰ A related concern, at least in relation to those DAFs established by donors with in house foundations of financial institutions, is that there are incentives for these foundations to keep the DAF assets for as long as they can, thereby presumably allowing their affiliated financial institution to continue to provide financial services to the DAFs and receive the fees associated with such services.⁸¹

Under the ITA, a disbursement quota (“DQ”) is imposed on all registered charities, including the recipient charities of DAFs.⁸² The DQ is the minimum calculated amount that a registered charity is required to spend each year on its own charitable programs or on gifts to qualified donees, such as other registered charities.⁸³ The historical purpose of the DQ has been to ensure that charities are using sufficient amounts of their tax-receipted gifts on charitable

⁷⁸ See Questions from Chair of the Special Senate Committee on the Charitable Sector (8 April 2019), online: <<https://sencanada.ca/en/Committees/CSSB/NoticeOfMeeting/519719/42-1>>.

⁷⁹ Madoff, *supra* note 13. See also question from Senator Ratna Omidvar at the Special Senate Committee on the Charitable Sector (23 April 2018), online: <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/02ev-53971-e>> [Omidvar (April 23)].

⁸⁰ *Supra* note 10.

⁸¹ Madoff, *supra* note 13.

⁸² ITA, *supra* note 1 at s 149.1(1).

⁸³ Canada Revenue Agency, “Disbursement quota calculation”, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/annual-spending-requirement-disbursement-quota/disbursement-quota-calculation.html>>.

activities/purposes, as well as to discourage charities from spending excessive amounts on fund raising and from accumulating excessive funds.⁸⁴

Currently, the DQ calculation is based on the value of a registered charity's property that is not used for charitable activities or administration. While in the past there were larger differences in the DQ requirements for charitable organizations as compared to public and private foundations,⁸⁵ there is currently a 3.5% DQ requirement imposed on all three types of registered charities.⁸⁶ Whether a registered charity is meeting its 3.5% DQ requirement under the ITA in any year is determined based on its disbursements on an aggregate basis, as opposed to on a fund-by-fund basis where a registered charity holds and manages individual restricted funds.⁸⁷

In relation to DAFs, questions have been raised about whether the CRA should examine if individual DAFs have been disbursing sufficient income each year at the minimum 3.5% DQ level,⁸⁸ or, on a related matter, whether it might be time to consider raising the DQ rate either to its earlier 4.5% rate,⁸⁹ or some other rate higher than 3.5%.⁹⁰ The concern appears to be that by only reviewing DQ requirements of a DAF charity on an aggregate basis, some individual DAFs may be able to "sit on" the assets for an indefinite period and not expend them to qualified donees for direct charitable activities. This could occur where certain DAFs held by a DAF charity make large disbursements to registered charities in a particular year, thereby boosting

⁸⁴ Donald Bourgeois, "What's The Law: Eliminating the Disbursement Quota: Gold Or Fool's Gold?" (18 May 2010) 23:2 *The Philanthropist*, online: <<https://thephilanthropist.ca/2010/05/whats-the-law-2/>>.

⁸⁵ Prior to 2010, the ITA imposed an 80% disbursement quota requirement on charitable organizations, in which they, subject to certain exceptions, were required to expend in a fiscal year 80% of the all amounts for which they issued official donation receipts in their preceding taxation year, excluding donations received for bequests, 10-year gifts (gifts subject to a trust or direction that the gift be held for at least 10 years) and gifts from other registered charities.

⁸⁶ This 3.5% rate is calculated on the average value of a registered charity's property not used directly in charitable activities or administration during the 24 months before the beginning of the fiscal year ("Average Value of Property"). The only DQ distinction between registered charities is that for charitable organizations, the DQ calculation is done when the Average Value of Property exceeds \$100,000, whereas for public and private foundations, the calculation is done when the Average Value of Property is in excess of \$25,000.

⁸⁷ *Income Tax Regulations*, CRC, c 945, s 3701. See also Theresa LM Man, *Charity Law Bulletin No. 150*, "Calculation Of 3.5% Disbursement Quota for All Registered Charities", online: Carters Professional Corporation <<http://www.carters.ca/pub/bulletin/charity/2008/chylb150.htm>>.

⁸⁸ Omidvar (April 23), *supra* note 79.

⁸⁹ See question from Senator Ratna Omidvar to Malcolm Burrows at the Special Senate Committee on the Charitable Sector (17 September 2018), online: <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/06ev-54208-e>>.[Omidvar (September 17)]

⁹⁰ Kathy Tomlinson, "Ottawa urged to tighten charity rules after multi-million dollar tax break revelations", *The Globe and Mail* (25 October 2018), online: <<https://www.theglobeandmail.com/canada/article-ottawa-urged-to-tighten-charity-rules-after-multimillion-dollar-tax/>>.

the DAF charity's overall disbursements for the said year and thereby fulfilling its annual DQ requirement.

To combat this, one proposed option is that the Government establish new requirements for minimum disbursements to be made by each and every DAF over to qualified donees, either by imposing reasonable payout terms over a set period of time or by delaying some of the tax benefits of charitable giving for donors until DAF assets are actually gifted to the qualified donees.⁹¹ Another possible approach that has been raised is whether these DAF disbursement concerns could be addressed by imposing a disbursement quota requirement (either the current 3.5% rate,⁹² or something higher⁹³) on individual DAFs.

In response to these concerns, it has been suggested by others in the charitable sector that the payouts associated with DAFs are not a significant concern and that there are other more pressing issues with DAFs that need to be addressed, such as the subject of too much donor control over DAFs.⁹⁴ This concern about potentially excessive donor control over DAFs will be addressed later in the paper.

Another important factor to keep in mind in considering this issue is that there are no known abuses of DAFs to date in Canada.⁹⁵ Recent research undertaken by Strategic Insights on DAFs has indicated that the average distributions from DAFs are “probably in the range of 12 per cent.”⁹⁶ Many DAF charities, including community foundations, have their own internal minimum disbursement policy requirements for each individual DAF.⁹⁷ As a way of addressing the issue, this may be a step that all DAF charities could, and should, undertake to establish internally, if they have not already done so.

⁹¹ Madoff, *supra* note 13.

⁹² Omidvar (September 17), *supra* note 89.

⁹³ *Supra* note 90.

⁹⁴ See testimony of Adam Parachin to the Special Senate Committee on the Charitable Sector (18 April 2019), online: <https://sencanada.ca/en/Committees/CSSB/NoticeOfMeeting/519719/42-1> [Parachin]. See also testimony of Karen Cooper to the Special Senate Committee on the Charitable Sector (18 April 2019), online: <https://sencanada.ca/en/Committees/CSSB/NoticeOfMeeting/519719/42-1>. [Cooper]

⁹⁵ See comment from Senator Ratna Omidvar at the Special Senate Committee on the Charitable Sector (24 September 2018), online: <https://sencanada.ca/en/Committees/CSSB/NoticeOfMeeting/498441/42-1>.

⁹⁶ *Supra* note 10.

⁹⁷ *Ibid.*

In relation to the suggestion that a different DQ rate be set for DAFs, this is of concern as it could potentially impact a broader range of registered charities than only those holding DAFs, specifically those charities which hold more traditional endowment funds, other restricted use trust funds, and the like. The worry here is that by taking a knee jerk reaction to try to remedy one perceived problem associated with DAFs, the existence of which is not at all clear, it could result in more significant impact to the broader charitable sector in another area.

2. Lack of Transparency and Accountability

A related issue to the concern about DAF disbursements is whether there is a lack of overall transparency and accountability associated with DAFs.⁹⁸ Questions have been raised in response to this concern about whether such issues could be addressed by requiring extra information to be included on the annual charity information returns (T3010s) of registered charities who hold DAFs.⁹⁹ For example, additional DAF related information to be provided on these charities' T3010s each year could include the number of DAFs that they either hold or held in the year, the total value of the assets held in the said DAFs both individually and collectively, as well as the total DAF distributions made to qualified donees, again both individually and collectively.

However, it is unclear whether such additional reporting requirements are either necessary or appropriate. Careful study of such proposals should be undertaken before a final determination is made. If, after review, it is determined that they are necessary, then it is possible that consideration would be given to whether such additional reporting requirements would need to apply to a registered charity holding not only DAFs, but also other types of special purpose charitable funds, such as endowments. Again, there is no evidence that a problem exists with regard to other types of restricted funds, so the issue becomes one of a solution in search of a problem.

⁹⁸ Omidvar (April 23), *supra* note 79; Omidvar (September 17), *supra* note 89.

⁹⁹ Omidvar (September 17), *ibid.*

3. Are Some DAFs Really Gifts at Law?

There are some in the charitable sector who have suggested that the more important issue to be examined in the area of DAFs is how much ongoing control a donor should have in relation to a DAF after he/she has made their gift.¹⁰⁰

This concern has been raised because one of the main “selling points” associated with DAFs is that they are more flexible than other structured giving options because they allow the donor to have, on an ongoing basis after the gift is made, “control” over the selection of the specific registered charities to receive disbursements from the DAFs, the amounts and timing of such disbursements, as well as even how the assets in the DAFs are managed, including investment practices. Many materials in the public domain describe a DAF as a donor’s “account” or “fund” within the DAF charity, which may lead the donor to believe that the DAF remains their property and is subject to their ongoing management and decision making.

On this point, it has been correctly observed by some in the charitable sector that there is a “disconnect” between how some DAFs work legally versus how they work functionally.¹⁰¹ Legally, a gift by a donor to a DAF works in the same way as an outright gift to any registered charity. However, in practice, there may be an understanding between the parties that the DAF operates as a “charitable chequing account” which the donor can control.¹⁰² As a result, DAFs have been described as “sitting in the nether region between private foundations and outright gifts to charities”.¹⁰³

These concerns regarding the issue of too much control by donors over DAFs after their gift(s) have been made have led some in the charitable sector to question whether these gifts have legally been made, as well as whether they are properly receiptable transactions in accordance with the ITA.¹⁰⁴ It has also been suggested that perhaps some of these DAFs arrangements “are

¹⁰⁰ Parachin, *supra* note 94.

¹⁰¹ Madoff, *supra* note 13.

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ Parachin, *supra* note 94; Cooper, *supra* note 94.

creating agency relationships more so than tax receiptable gifts”.¹⁰⁵

On this issue, as explained in detail earlier in this paper, it is certainly possible, if structured correctly, to both legally establish and operate a DAF within a DAF charity. However, the key to doing so is to ensure that the donor to a DAF only holds a limited purpose advisory role in relation to any subsequent decision making by the DAF charity as the owner of the DAF assets.

4. Monies Transferring to DAFs

Another concern being raised about DAFs relates to the issue of monies which are transferred from one DAF to another DAF or, alternatively, from a private foundation to a DAF, with the transferred monies then potentially accumulating in the recipient DAF.¹⁰⁶ The perceived worry is that the gifting charity is using the transferred monies to meet its applicable DQ requirement but the DAF charity may not subsequently expend any portion of the said monies to make gifts from the DAF over to qualified donees. As a result, these monies could just be continually circulated amongst DAF charities and not actually be used to conduct real charitable work.

In response, it is important to bear in mind that the ITA and the CRA already have anti-avoidance rules in place to address this issue.¹⁰⁷ Generally speaking, these rules require that if a registered charity receives a gift from another registered charity that is not at arm’s length,¹⁰⁸ then the recipient charity must spend 100% of the fair market value of the gift (which is to be determined at the time of the gift) either on: (1) its own charitable activities; or (2) gifts to qualified donees that are at arm’s length.

A registered charity is required to comply with this anti-avoidance spending requirement either in the fiscal year in which the gift was received or in the one immediately following. If the

¹⁰⁵ Parachin, *ibid.*

¹⁰⁶ See testimony of Mark Blumberg to the Special Senate Committee on the Charitable Sector (19 November 2018), online: <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/09ev-54400-e>>.

¹⁰⁷ Canada Revenue Agency, “Anti-avoidance rules and designated gifts”, online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/receiving-gifts/anti-avoidance-rules-designated-gifts.html>>.

¹⁰⁸ See Canada Revenue Agency, Income Tax Folio S1-F5-C1, Related Persons and Dealing at Arm’s Length, online: <<https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-1-individuals/series-1-individuals/income-tax-folio-s1-f5-c1-related-persons-dealing-arms-length.html>>.

charity does not spend the required amount within that time, then it may be subject to a penalty of 110% of the amount that it failed to spend, and may even face revocation of its registered status.¹⁰⁹ It is important to note that these anti-avoidance spending requirements are in addition to a recipient charity's mandated DQ requirements for the applicable fiscal year.

The alternative option is for the donor charity to designate its gift to a recipient charity in accordance with the ITA requirements explained below, in which case the recipient charity would not be subject to the additional spending requirement described above. A designated gift is a type of gift made between registered charities that are not at arm's length. To designate a gift, the donor charity must indicate that the gift is a designated gift in its information return for the fiscal period in which the gift is made.¹¹⁰ It is important to be aware, however, that the donor charity will not be permitted to use the designated gift to satisfy its applicable DQ requirements. Accordingly, the amount of designated gifts included at line 5050 (gifts made to qualified donees) must be subtracted when a donor charity calculates if it has met its disbursement quota.¹¹¹

E. How to Work with DAFs

1. Properly Establishing and Managing DAFs

Difficulties can arise with DAFs if there is either a lack of understanding of what a DAF is at law and how it is required to legally operate once established, or if there is a failure on the part of both charities and their donors to implement appropriate practices in the day-to-day operation of a DAF. Given that this topic could itself be the subject of an entire paper, this section is only intended to provide some initial comments on these issues for the reader's consideration.

¹⁰⁹ *Supra* note 107.

¹¹⁰ Specifically the Form T1236, *Qualified Donees Worksheet/Amounts Provided to Other Organizations*. On this issue, the CRA advises that, in this form, on the blank line below the political activities question, the donor charity must write the words "designated gift" and the amount of the gift that is designated. For the T1236, see Canada Revenue Agency, *T1236, Qualified Donees Worksheet/Amounts Provided to Other Organizations*, online: Government of Canada <<https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t1236/t1236-19e.pdf>>.

¹¹¹ The CRA also recommends that the donor charity inform the recipient charity that a gift is a designated gift in order to allow the recipient charity to adequately track its own spending requirement for the fiscal period.

As referenced above, the key to successfully establishing and managing a DAF is to ensure that, first, ownership of the DAF and all of its assets is held by the DAF charity and, second, that the DAF charity retains control over all decisions associated with the fund, including investing and ongoing gift making to qualified donees. In this regard, the DAF charity must ensure that it takes all necessary steps to appropriately advise its donors, both initially and on an ongoing basis, that their input in relation to the DAF can be of an advisory nature only.

To evidence that the DAF charity has properly advised the donors of their advisory role regarding the DAF, the documents creating any DAF must clearly state that it is the DAF charity which administers the fund and that the DAF charity explicitly reserves the right to not follow the donor's suggestions, advisements, or recommendations regarding how monies in the fund are to be distributed or applied by the DAF charity.¹¹² Although not an exhaustive list, this gift agreement establishing the DAF could also address the following issues:

- (1) the name of the DAF;
- (2) the minimum initial amount required to establish the DAF;
- (3) the amount of time that a donor has to contribute gifts in order to reach this minimum amount and what will happen if the minimum amount is not achieved by the donor;
- (4) how often gifts to qualified donees will be made from the DAF assets by the charity and in what minimum amount per year;¹¹³
- (5) if desired by the donor, the general parameters of the type of qualified donees to be recipients of gifts from the DAF;¹¹⁴

¹¹² *Supra* note 71 at 37.

¹¹³ This is an example of a provision which would turn a gift to a DAF (which is not, in and of itself, a restricted gift) into a restricted charitable purpose trust with a time restriction for distribution, which might also be subject to a use restriction if the donor so desired.

¹¹⁴ The donor may wish to impose such restrictions from the outset in the event that the donor does not provide his/her advice in a particular year or if such donor advice is not followed by the charity upon receipt from the donor for any reason. If this step is taken by the donor, then, similar to the comments in note 113 above, this would also serve to turn the gift to the DAF

- (6) the manner and how often the donor's advice on the recipients of gifts from the DAF will be sought;
- (7) if and how the donor is permitted to appoint a successor advisor for the DAF;
- (8) any special investment powers to be provided to the charity in relation to the DAF assets;¹¹⁵ and
- (9) if desired, a requirement that the donor's advice (but not approval) be sought if the charity decides to transfer the DAF to another registered charity through a change of trustee in accordance with the *Trustee Act* (Ontario).

The gift agreement establishing the DAF should originate from the DAF charity itself based upon input from its legal counsel, be thoroughly reviewed with the donor who should then obtain independent legal advice regarding the agreement's terms, and thereafter signed by both of the parties. In so doing, this agreement will properly document the giving of the initial gift by the donor, but also crystallize the restricted terms of the DAF as agreed upon by the parties. This written agreement will also ensure that the donor was fully advised of the limited nature of advice that he/she will be able to provide to the DAF charity and that the ultimate decision making authority over the DAF belongs to the DAF charity. This is absolutely necessary to ensure that the donations made by the donor to the DAF are true gifts at law and can be receipted as such under the ITA.

Once a decision has been made to accept a gift from the donor to establish a DAF, then the DAF charity and its management must be careful to ensure that the DAFs are properly managed in accordance with all applicable legal requirements. Appropriate management would involve the following steps:¹¹⁶

into a restricted charitable purpose trust. In so doing, the donor will have general assurance that the annual gifts from the DAF are being given to qualified donees within the parameters of his/her said restriction.

¹¹⁵ This is another example of a possible donor restriction that could be imposed by the donor at the outset, turning the DAF into a special purpose charitable trust.

¹¹⁶ *Supra* note 54 at 85-86.

- (1) comply with all donor restrictions, as well as any donor advice requirements set out in the gift agreement, as well as reporting back requirements to the donor;
- (2) ensuring that each DAF is tracked and managed by the DAF charity separately from any other DAFs or other restricted trust funds that it may hold;
- (3) ensuring that the assets in the DAF are invested in accordance with the specific investment powers set out in the gift agreement or, if there is no special investment power, in accordance with the general investment powers of the charity;
- (4) ensuring that each DAF, together with any other DAFs and restricted trust funds held by the charity, are not commingled with its general funds, with recognition that a DAF can be commingled with other DAFs and restricted trust funds for investment purposes subject to any special investment powers applicable to certain funds;¹¹⁷
- (5) being aware that the proceeds from the sale of charitable property held in a DAF remains impressed with the same donor restrictions imposed at the time the DAF was originally established; and
- (6) ensuring that any transfer of a DAF over to another charity must be done by way of a written appointment in accordance with section 3 of the *Trustee Act* (Ontario) to document the change of trustee.

2. Practical Advice for Advising Clients

In terms of practical advice for legal practitioners working with their registered charity clients on DAFs, the following recommendations should be considered:

- a) Do your homework ahead of time – Take the time and do the appropriate due diligence to figure out how to do DAFs right from the outset, and advise your charity clients accordingly.

¹¹⁷ See, for example, *Approved Acts of Executors and Trustees*, O Reg 4/01, s 3, for regulations on commingling funds in Ontario.

Some due diligence best practice suggestions that you may recommend and work with your clients to put in place in relation to DAFs include: developing and implementing written gift acceptance policies addressing DAFs among other gifting vehicles; utilizing checklists to ensure consistent treatment of gifts to DAFs; encouraging clear communications with donors before gifts to DAFs are made; preparing appropriate gift agreements to establish DAFs; and then advising the charity how to manage and administer DAFs correctly in accordance with their obligations under the ITA.¹¹⁸ If DAFs cannot be established and administered legally by either the charity or any of its donors, then they should not be done at all.

- b) Create templates – Any charity interested in receiving gifts through DAFs are strongly advised to create their own template documents to do so, as well as systems for their management on a day to day basis. Legal counsel should be prepared to discuss the need for and importance of template gift agreements and related documents with their charity clients and draft appropriate templates in accordance with the charity’s needs.
- c) Ensure that the Charity Runs the Process – The charity with assistance from its legal counsel as needed, and not the donor or their legal counsel, should be in control in establishing DAFs, utilizing consistent procedures as set out in policy together with temple gift agreements.
- d) Be Vigilant – Any charity considering receiving gifts of DAFs needs to be aware of how things can go awry and avoid them entirely, *e.g.* avoid referring to DAFs as “accounts” or that donors are “clients”, engaging in any marketing or communications which suggest that a DAF “belongs” to the donor, that the donor makes all decisions in relation to the DAF or that the DAF is the donor’s own “private foundation”.¹¹⁹ Legal practitioners need to be aware of these potential issues as well in order to properly advise their charity clients on how to avoid future problems with DAFs.

¹¹⁸ Carter and Man, *supra* note 50 at slides 61-66.

¹¹⁹ Margaret Mason, “Knowing Your Donor and Money Laundering” (PowerPoint presentation, April 2018) at slides 17-18. This power point presentation also addresses other areas of confusion with DAFs in addition to marketing communications.

F. Conclusion

DAFs that are properly set up and operated correctly can be very helpful in facilitating gifts for the charitable sector and, as such, a charity should consider whether DAFs might be worthwhile to make available to its donors. However, before a charity or a donor becomes involved in a DAF, it is essential that both parties clearly understand what it is at law, how it must be properly established as a legal charitable gift in order that a charitable donation receipt can be issued in exchange for the gift, and how the DAF is to operate, from a functional standpoint, within the DAF charity on a day-to-day basis. If all legal aspects of a DAF are not complied with, then the donor's gifts to it might be potentially invalidated and either preclude a charitable donation receipt being issued at the time of the gift or, worse yet, potentially see the said receipt being invalidated by the CRA at a future date.

Given the current size and scope of DAFs in the charitable sector, the reality is that DAFs are not going away and presumably will continue to grow in number and overall dollar value. While it is recognized that donors prefer making charitable gifts that are subject to restrictions as a means of retaining some measure of control over their philanthropy, too much control by donors may undermine the validity of their charitable gifts in the long run. For these reasons, registered charities, donors and the legal counsel advising each of them need to be aware from the outset the legal underpinnings of DAFs, what is required to both establish and operate them properly, as well as the potentially serious consequences of not doing so. It has been the intention with this paper to further the reader's understanding of these issues and it is hoped that this intention has been achieved.