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# HRN THEMATIC MEETINGS LOCALIZATION

May 17, 2021

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## LOCALIZATION: CRA CHALLENGES, POSSIBLE REFORM AND PRACTICAL TIPS

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By Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent

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### HRN Thematic Meetings Localization Monday, May 17<sup>th</sup>, 2021

## Localization: CRA Challenges, Possible Reform and Practical Tips

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### A. CANADA REVENUE AGENCY (“CRA”) CHALLENGES WHEN IMPLEMENTING LOCALIZATION

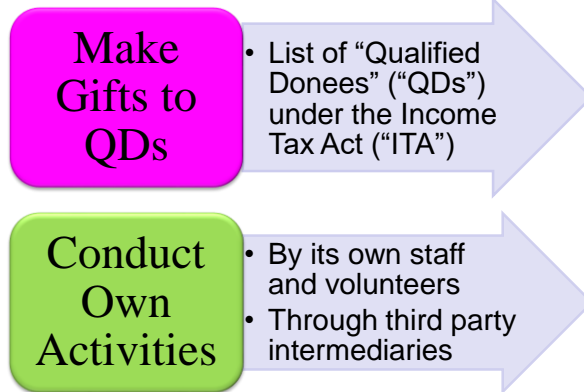
- CRA Guidances on Foreign Activities and Intermediaries updated November 27, 2020
- Updated Guidance CG-002 *Canadian Registered Charities Carrying On Activities Outside Canada*  
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-002-canadian-registered-charities-carrying-activities-outside-canada.html>
- Updated Guidance CG-004 *Using An Intermediary to Carry On a Charity’s Activities Within Canada*  
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/using-intermediary-carry-a-charity-activities-within-canada.html>
- See *Charity and NFP Law Bulletin No. 484* for details  
<https://www.carters.ca/pub/bulletin/charity/2021/chylb484.pdf>

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- **Only Two Ways a Charity may Use its Resources**

- A charity can conduct its activities outside of Canada in only two ways



## 1. Making Gifts to Qualified Donees (“QDs”)

- Registered charities can make gifts to QDs
- “Qualified donee” is defined in the ITA
- QDs in Canada
  - Registered Canadian charities (including registered Canadian national arts service organizations)
  - Registered Canadian amateur athletic associations
  - Registered journalism organizations
  - Registered housing corporations resident in Canada constituted exclusively to provide low-cost housing for the aged
  - Registered Canadian municipalities
  - Her Majesty in right of Canada or a province
  - Registered municipal or public bodies performing a function of government in Canada

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- QDs outside of Canada
  - Registered universities outside Canada with student body that ordinarily includes students from Canada
  - Registered charities outside Canada that have received a gift from the government of Canada in past 24 months and pursue activities related to disaster relief or urgent humanitarian aid or in the national interest of Canada
    - A rolling list
  - The United Nations and its agencies
    - *E.g.* UNCDF, ILO, IFC, UNICEF

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## 2. Conducting Own Activities

### a) General CRA Requirements

- Activities must be that of the charity itself directly under the charity's direction and control, and for which it can account for any funds expended = "own activities" test
- CRA recognizes two ways to meet this test
  - A charity sending its own staff, directors and volunteers on the ground to conduct the activities
  - Through third parties - "intermediaries"
- Third party intermediaries do not have to be QDs, can be non-QDs, such as for-profits, non-profit organizations ("NPOs"), international NGOs outside of Canada

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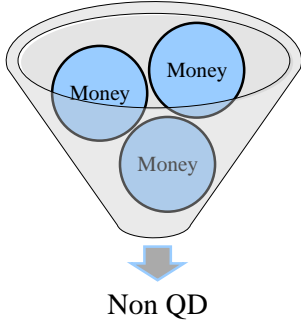
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- Activities funded are activities of the Canadian charity, not activities of the third party intermediaries (to meet “own activities” test under the ITA)
  - A charity cannot fund third parties to support the programs of the third party
  - A charity must transfer funds to third party to conduct the charity’s own program on behalf of the charity - *i.e.*, it is the charity’s programs
- Guidance states that “[w]hen working through an intermediary, a charity must direct and control the use of its resources” = “direction and control” is key

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- A charity cannot act as a “conduit” to funnel money to non-QDs
  - A conduit is an organization that accepts donations for which it typically issues tax-deductible receipts and then funnels the money, without maintaining direction and control to a non-QD
  - To avoid being a conduit, the Canadian charity must have demonstrable direction and control over the use of its resources



Non QD

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### b) Types of Intermediaries Acceptable to CRA

- Three common types of intermediaries that can be used

- Consultants or Contractors**
- Joint venture participants**
- Co-operative participants**

- Agents no longer listed as a “common type”
- Can have other types of intermediary relationships
- CRA does not recommend using one over the other
- Regardless of which option is used
  - Must meet own activities test
  - Must maintain direction and control

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### c) CRA Requirements for Direction and Control

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graph TD; A[Written Agreement] --> B[Active Monitoring]; B --> C[Ongoing Instructions]; C --> D[Periodic Payments]; D --> E[Books and Records]; E --> A;
```

The diagram illustrates the CRA requirements for direction and control as a continuous cycle of five interconnected elements:

- Written Agreement** (Yellow box)
- Active Monitoring** (Red box)
- Ongoing Instructions** (Yellow box)
- Periodic Payments** (Green box)
- Books and Records** (Blue box)

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## Written Agreement (above \$5,000)

- Having a written agreement and implementing its terms is recommended by CRA when expending more than \$5,000
- Ensure the agreement accurately reflects the working relationship between the parties
- Ensure the agreement is implemented
- CRA's Guidance has requirements on what to be included in an agreement
  - Legal name and location of parties
  - Clear, complete, and detailed description of activities is communicated to the intermediary
  - Location where activities to be conducted
  - Right of the charity to inspect the activities and related books and records on reasonable notice
  - Make periodic transfers based on performance
  - Give ongoing instructions

- For joint venture - mechanism to give proportionate degree of control
- Effective date and termination provisions
- Signature of all parties

**Monitor and Supervise the Activity** - *i.e.*, receiving timely and accurate reports to make sure that its resources are being used for its own activities

- Regular progress reports
- Receipts for expenses and financial statements
- Informal communication via telephone or email
- Photographs
- On-site inspections by the charity's staff

# MONITOR

## Need for Books and Records

- Charities must maintain document trail to evidence due diligence and compliance with CRA requirements
- Upon CRA audit, CRA has right to access all books and records pertaining to the operations (not just financial records) – including written agreements, proposals, working papers, reports from intermediaries, emails, memos, committee meetings, records of phone meetings, website, publications, etc., as well as website, Facebook, publications of intermediaries
- Need to take care what is recorded in these documents
- Need to use appropriate language in all documents
- Consider educating intermediaries on CRA rules in which the charity works and the language that should be used when communicating with the charity

## d) What's New in Revised Guidances : Key Differences

- **Previous Guidances**
  - 4 common types of intermediaries - agency, contractor, joint venture participant, and co-operative participant
  - One-time activity involving \$1000 or less does not need a written agreement, when other forms of communication available to show direction and control
- **Revised Guidances**
  - 3 common types of intermediaries: consultant or contractor, joint venture participant, co-operative participants ("agency" no longer included)
  - One-time activity involving \$5000 or less does not need a written agreement, when other documents might be enough to show ongoing direction and control







## 2. **Bill S-222, *Effective And Accountable Charities Act***

- Hon. Ratna Omidvar, Senator for Ontario, tabled Bill S-222, the *Effective and Accountable Charities Act* for first reading on February 8, 2021
  - Will hopefully provide registered charities in Canada with needed reform of the ITA concerning how they can work with organizations that are not “qualified donees”
  - Expected to receive broad support from the charitable sector
    - Thirty-seven charity lawyers in Canada signed an open letter explaining the need for reform and to eliminate “own activities” requirement
    - See February 19, 2021 open letter [www.carters.ca](http://www.carters.ca)
  - See *Charity and NFP Law Bulletin No. 486*  
<https://www.carters.ca/pub/bulletin/charity/2021/chylb486.pdf>

### a) **Historical justification for “Own Activities”**

- The requirement that “all the resources” of a charitable organization be “devoted to charitable activities carried on by the organization itself” has remained since 1950
- Intended to prevent charitable organizations from “circulating funds endlessly or sheltering them without actually using them for charitable relief”
- It is highly doubtful whether the historical basis or rationale for the requirement that charitable organizations must devote all their resources to charitable activities carried on by the organizations themselves continues to be valid in 2021
- See Terrance S. Carter & Theresa L.M. Man, “Direction and Control: Current Regime and Alternatives”  
<https://www.carters.ca/pub/article/charity/2020/Direction-and-Control-Current-Regime-and-Alternatives.pdf>



## c) Proposed changes of Bill S-222

- Bill proposes to:
  - Remove the fictitious “own activities test”
  - Expand the definition of “charitable activities”
  - Allow resources to be available to non-qualified donees as part of charitable activities
    - ’ Provided that “reasonable steps” are taken
- Aligns with ACCS Report #1 recommendations to eliminate “own activities” test and replace “direction and control” with “resource accountability”


- Removal of “own activities” test by changing ss. 149.1, 188, 188.1 and 189 of the *ITA*
  - Requiring charities to carry on “charitable activities” instead of “charitable activities ~~carried on by it~~”
- Would amend the definition of “charitable activities” to provide for a “resource accountability” type of test in s.149.1(1) by adding a paragraph:
  - “(b) making resources — including grants, gifts or transfers — available by transactions, arrangements or collaborations of any kind whatsoever in furtherance of a charitable purpose to a person that is not a qualified donee if those resources are made available by a charity that takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose in accordance with subsection (27)”

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

- Bill S-222 as tabled would come into force two years after Royal Assent
- Sen. Omidvar moved second reading of Bill S-222 on March 16, 2021
- In her speech, Sen. Omidvar noted that Canadian charities cannot realistically participate in pooled efforts with non-Canadian charities to address international development issues
- See *Charity and NFP Law Bulletin No. 488*  
<https://www.carters.ca/pub/bulletin/charity/2021/chylb488.pdf>
- It is important to support and monitor this Bill
  - There may be possible amendments as it makes its way through Parliament
  - Stay tuned!

## C. PRACTICAL TIPS TO EVIDENCE DIRECTION AND CONTROL

- Consider conducting a “pre-audit” in anticipation of a possible CRA audit of foreign activities
- Identify all foreign activities/ programs engaged in by the charity with intermediaries for a particular time frame
- Identify who the intermediaries are
- Identify the nature of the relationship, e.g. agency, contract for service, joint venture
- Identify whether a intermediary utilizes a subcontractor, in which event a separate subsidiary agreement may be required
- Create a folder for each foreign activities project
- Put together a compliance checklist for each project

- Required documents for a checklist –  indicate if required documents have been located, date completed and if any additional steps need to be taken
  - Original project proposal
  - Board approval of project (include copy of applicable board minutes)
  - Written agreement
  - Project designation(s) for contractor/agent (for initial and any interim fund transfers)
  - Wire transfer and letter
  - Any sub-agreement, if applicable

CHECKLIST

- Sub-project designation(s)  
(for initial and any interim fund transfers)
- Interim project reports and, if applicable, sub-project reports
- Final project reports and, if applicable, sub-project reports
- Board acceptance of all project reports (include copy of board minutes)
- Photographs, brochures and other evidence that project took place

CHECKLIST

- Any correspondence between the charity and contractor showing charity's supervision of and involvement in the project
- On-site visit reports by charity's directors, staff and/or volunteers
- External auditor report of on-site visits
- Receipts/vouchers or audit letter in lieu of receipts/vouchers
- Additional notes, as required
- Need to complete the checklist for each project folder and, in so doing, identify which steps have (or have not) been taken by the charity and which documentation is (or is not) readily available



- Need to prepare progress reports and pre-audit compliance reviews with the board of directors of the charity
  - Point out deficiencies, if any
  - The board of directors need to feel a sense of ownership in the process
  - The board needs to oversee compliance process
- If deficiencies are found, need to work with legal counsel to review options in how to respond and how to ensure compliance in the future
- Essential to maintain “solicitor-client privilege” while reviewing compliance deficiencies



**Terrance S. Carter**, B.A., LL.B, TEP, Trademark Agent Managing Partner of Carters, Mr. Carter practices in the area of charity and not-for-profit law, and is counsel to Fasken on charitable matters. Mr. Carter is a co-author of *Corporate and Practice Manual for Charitable and Not-for-Profit Corporations* (Thomson Reuters), a co-editor of *Charities Legislation and Commentary* (LexisNexis, 2021), and co-author of *Branding and Copyright for Charities and Non-Profit Organizations* (2019 LexisNexis). He is recognized as a leading expert by *Lexpert*, *The Best Lawyers in Canada* and *Chambers and Partners*. Mr. Carter is a member of CRA Advisory Committee on the Charitable Sector, and is a Past Chair of the Canadian Bar Association and Ontario Bar Association Charities and Not-for-Profit Law Sections. [tsc@carters.ca](mailto:tsc@carters.ca)

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