

VIRTUAL 2022 FALL TAX EXEMPT ORGANIZATIONS SYMPOSIUM

Update on Key Developments in the Law in Canada Affecting Charities Subcommittee on International Philanthropy September 8, 2022

The Panel



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Robert Hayhoe is a leading adviser in the charities and non-profit sector in Canada. Certified by the Law Society of Ontario as a specialist in Tax Law, Robert provides both general counsel and specialized tax advice to charities and not-for-profit organizations across Canada. He is the principal author of *Charities Taxation: Policy and Practice* (Thomson Reuters). Robert is recognized as a leading expert by *Lexpert*, *The Best Lawyers in Canada* and *Chambers and Partners*.

Objectives

- Increase awareness of recent and proposed changes in Canadian law affecting charities and not-for-profits that operate in Canada, specifically regarding:
 - The new regime of qualifying disbursements
 - Amendments to the disbursement quota
- Obtain a high level understanding of some recent issues which may arise when engaging in cross-border transactions with Canadian charities
- Gain insight into how Canadian anti-terrorism law unnecessarily places impediments on Canadian charities operating in conflict zones, with a focus on restrictions on operating in Afghanistan

I. Qualifying Disbursements Regime

Former Regime: Own Activities & Direction and Control

- The *Income Tax Act* (Canada) formerly allowed charities to use their resources in two ways:
 1. Make gifts to qualified donees (“QDs”)
 2. Conduct “own activities” with:
 - a) the charity’s own staff and volunteers, or
 - b) through 3rd party intermediaries (non-QDs) by means of detailed written agreements

QDs include (among others): registered charities, different levels of Canadian government, registered universities outside of Canada where the student body ordinarily includes students from Canada, registered charitable organizations outside of Canada to which Her Majesty in right of Canada has made a gift, and the United Nations and its agencies

- The “own activities” test in the *Income Tax Act* requires that activities must be that of the charity itself (even if that is a legal fiction) that are directly under the charity’s direction, control and supervision, and for which it can account for any funds expended
- The Canada Revenue Agency’s (“CRA”) policy of “direction and control” requires that a charity direct and control the use of its resources when working through an intermediary

New Qualifying Disbursements Regime

- The own activity/direction and control regime has been criticized as being outdated (not reflecting international development philosophy), impractical, imposing high administrative costs, and facilitating paternalistic relationships between charities and local communities, including some of Canada’s Indigenous communities that were not registered charities or other types of qualified donees.
- This has led to considerable pressure from the charitable sector for legislative change
- Bill C-19, *Budget Implementation Act, 2022, No. 1* received Royal Assent on June 23, 2022, amending the *Income Tax Act* to establish a new regime of “qualifying disbursements” to “grantee organizations”
- Both terms are defined in subsection 149.1(1) of the Act:
 - A qualifying disbursement is a disbursement made by a charity, by way of gift or by otherwise making resources available to a qualified donee (subject to certain requirements) or to a grantee organization (subject to certain requirements set out on the next slide)
 - A grantee organization includes a person, club, society, association or organization or prescribed entity, but does not include a qualified donee

New Qualifying Disbursements Regime (cont'd)

- Now, the *Income Tax Act* allows Canadian charities to use their resources in three ways (changes in orange):
 1. Conduct “own activities” with:
 - a) the charity’s own staff and volunteers, or
 - b) through 3rd party intermediaries (non-QDs)
 2. Make **qualifying disbursements** to QDs
 3. **Make qualifying disbursements to grantee organizations if**
 - a) **The disbursement furthers a charitable purpose of the funder charity**
 - b) **The funder charity ensures that the disbursement is exclusively applied to charitable activities in furtherance of the funder charity’s charitable purpose; and**
 - c) **The funder charity maintains documentation sufficient to demonstrate the purpose for which the distribution was made and that the disbursement was exclusively applied by the grantee organization to charitable activities in furtherance of the funder charity’s charitable purposes**

Implications of New Qualifying Disbursements Regime

- With the introduction of a third way for Canadian charities to use their resources, charities will be able to give gifts to a broader range of organizations than before, including non-qualified donees (QD)
- Before, only a limited number of non-Canadian organizations met the definition of QD (such as universities outside of Canada that have sufficient Canadian students enrolled, the UN or agencies of the UN)
- Now, it is possible that more non-Canadian organizations will be eligible to receive qualifying disbursements as defined above as grantee organizations
- The own activities test and direction and control requirements remain unchanged as an option for charities when working with non-QDs outside of Canada
- Charities may also still decide to make gifts to QDs as before
- It is not yet known whether impact investing (described by the CRA as Program Related Investments (“PRI”)) will be considered to be a qualifying disbursement but they should be

Issues to be aware of with Qualifying Disbursements

- “Anti-directed gift” provisions were also introduced with the effect that a registered charity may have its charitable status revoked if it accepts a gift, the granting of which is expressly or implicitly conditional on the charity making a qualified disbursement to another person or organization.
 - Prevent a charity from acting as a shared fundraising platform for other organizations that are not QDs
 - Canadian charity may fundraise for a particular program (e.g. humanitarian aid for refugees fleeing the war in Ukraine) provided that the fundraising communications do not mention any particular non-QDs that the charity intends as grantee organizations?
 - May also prevent Canadian charity in an international affiliation from making qualified disbursements to sister organizations (“implicitly conditional”?)
- Not clear how pooling of funds with non-QDs will work as qualifying disbursements.
- Further guidance from CRA needed

Issues to be aware of with Qualifying Disbursements (cont'd)

- Although qualifying disbursements are now a part of Canadian law, the CRA has not yet released policy guidance. Until this guidance is released, charities should be cautious before making qualifying disbursements to grantee organizations
- In part due to a lack of guidance, charities may be unsure about which of the three options they should adopt when using their resources (*i.e.* own activities and direction & control; qualifying disbursements to QDs; or qualifying disbursements to grantee organizations)
 - Delay deciding until CRA policy released
- The Income Tax Regulations now contain reporting requirements in Regulation 3703 which requires charities to report about any grantee organization to which the charity has given more than \$5,000 in qualifying disbursements in a year, including the purpose of the disbursement. This information may then be available to the public, though clarification from the CRA about how such information will become available is not yet known

II. Disbursement Quota Amendments

Draft Legislation Proposes Increase of Disbursement Quota

- Unlike in the US where the disbursement quota only applies to private foundations, in Canada the disbursement quota (DQ) applies to all charities, regardless of whether they are charitable organizations, private foundations or public foundations
- The DQ is the minimum amount that a charity must spend on its charitable activities or gifts to qualified donees to ensure that charitable property is not accumulated indefinitely
- The DQ obligation is currently 3.5% of property owned by a charity at any time in the preceding 24 months not used directly in charitable activities or administration and applies only if the value of this property exceeds \$25,000 (for private or public foundations) or \$100,000 (for charitable organizations)
- Draft legislation has been released by the Department of Finance Canada on August 9, 2022 that proposes to increase the DQ rate to 5% for eligible property held by a charity in excess of \$1 million
 - It is expected that the proposed changes reflected in this draft legislation will appear in budget implementation legislation to be introduced in Canada's Parliament in late September 2022

Disbursement Quota Chart

Types of Charity and Value of Property* Held by the Charity	Current DQ Obligation	Proposed New DQ Obligation
Charitable Foundation with ≤\$25,000 of property	Nil	Nil
Charitable Organization with ≤\$100,000 of property	Nil	Nil
Charitable Foundation with >\$25,000 and ≤\$1,000,000 of property	3.5% of property	3.5% of property
Charitable Organization with >\$100,000 and ≤\$1,000,000 of property	3.5% of property	3.5% of property
Charitable Foundation with >\$1,000,000 of property	3.5% of property	\$35,000 + 5% of the amount of property which exceeds \$1,000,000
Charitable organization with >\$1,000,000 of property	3.5% of property	\$35,000 + 5% of the amount of property which exceeds \$1,000,000

* "property" refers to "property owned by the charity in the preceding 24 months that is not used directly in charitable activities or administration as determined under sections 3701 and 3702 of the Regulations

Issues Posed by an Increased Disbursement Quota

- Charities with property in excess of \$1 M that is not used directly in charitable activities or administration may have difficulty in meeting a higher 5% DQ, especially those with endowments where the capital is to be held in perpetuity or for a certain time period
 - These charities might not be able to earn sufficient income on their investments or might need to pursue riskier investments contrary to their duty to comply to a prudent investor standard under provincial trustee legislation
 - Charities may also have to apply to court to vary the terms of an endowment
- The draft legislation proposes to add a provision which would make it clear that expenditures on administration and management of a charity will not satisfy a charity's DQ obligation
 - Further guidance from the CRA is needed
- Charities may request a reduction in their DQ obligation, but the proposed legislation will allow the CRA to make any such requests and responses publicly available (it is unclear if this information will be posted online or merely available upon request)

Issues in Meeting the Disbursement Quota

- The CRA does not consider PRIs to be property that a charity must include in its asset base when calculating its DQ obligation (*i.e.* property not used directly in charitable activities or administration)
 - However, PRIs are not considered to be charitable expenditures that meet a charity's DQ obligation (except in limited circumstances where the charity is unable to recover part or all of the principal of a PRI or where there are lost opportunity costs)
 - It is hoped that with the introduction of qualifying disbursements in the *Income Tax Act*, that impact investing (PRIs) will be considered to be a charitable expenditure for the purposes of meeting a charity's DQ obligation
- Charities must continue to comply with anti-avoidance rules, including that a charity that receives a gift from a non-arm's length charity must use 100% of the gift on its own charitable activities or gifts to QDs in the fiscal period the gift was received or in the following fiscal period or otherwise elect to make the gift a designated gift
 - Failure to do either could result in a 110% tax on the unused amount or revocation of charitable status

III. Canadian Law & NGOs in Afghanistan

Canadian NGOs in Afghanistan

- Following the return to power of the Taliban in Afghanistan in August 2021, the US Department of the Treasury issued General Licenses to allow for the continuance of humanitarian aid in Afghanistan
- Unfortunately, Canada is the only significant donor/funder to Afghanistan that has not provided some form of exemption to ATF/AML rules for humanitarian aid
- *Regulations Implementing the United Nations Resolutions on Taliban, ISIL (Da'esh) and Al-Qaida*, SOR/99-444 under the *United Nations Act*, at section 2, prohibit any person from knowingly providing any property or financial services to or for the benefit of any person or entity associated with the Taliban
 - An exemption is available, but it does not specifically concern humanitarian action, is difficult to obtain, and does not address legal requirements in other legislation
- The Canadian *Criminal Code* at subsection 83.03(b) and section 83.04 makes it an offence to directly or indirectly collect property, provide or invite a person to provide, or make available property or financial or other related services “knowing that, in whole or part, they will be used by or will benefit a terrorist group” and an offence to directly or indirectly use property in whole or in part for the purpose of facilitating a terrorist activity

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Canadian NGOs in Afghanistan (cont'd)

- Additionally, charities may face potential revocation of their registered charitable status if there are reasonable grounds to believe that they have made, are making, or will make available any resources, directly or indirectly, to a listed terrorist entity, if a certificate (effective for up to seven years) is issued under sections 4, 5 and 13 of the *Charities Registration (Security Information) Act*
- The Canadian chapters of multi-national NGOs have reported that they are the only national chapters in their network whose operations in Afghanistan have not resumed since August 2021 and that programs for which the Canadian organizations are the sole external funder will likely be forced to closed
- In response, the Canadian Bar Association has written an open letter to the Minister of Justice and Attorney General of Canada, the Honourable David Lametti, PC, MP, as well as to the Minister of Public Safety, the Honourable Marco Mendicino, PC, MP, urging the Ministers to adopt several recommendations to change Canada's ATF/AML regime as it applies to humanitarian aid (see Additional Resources page for links)

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Additional Resources

- Update on Qualifying Disbursements
 - <https://www.carters.ca/pub/bulletin/charity/2022/chylb513.pdf>
 - <https://www.millerthomson.com/en/publications/communiques-and-updates/social-impact-newsletter/may-2-2022-social-impact/new-qualifying-disbursements-rules/>
 - <https://www.millerthomson.com/en/publications/communiques-and-updates/social-impact-newsletter/june-6-2022/non-qualified-donees-canadian-charities-funding/>
- Summary of Disbursement Quota Requirements and Proposed Changes
 - <https://www.carters.ca/pub/bulletin/charity/2022/chylb515.pdf>
 - <https://www.carters.ca/pub/bulletin/charity/2022/chylb507.pdf>
 - <https://www.millerthomson.com/en/publications/communiques-and-updates/social-impact-newsletter/april-7-2022-social-impact/2022-federal-budget-charitable-npo-sector-highlights/>
 - <https://www.ctf.ca/CTFWEB/EN/NEWSLETTERS/PERSPECTIVES/2022/1/220106.aspx>
- Canadian Bar Association, Open Letter, re: Afghanistan
 - <https://www.carters.ca/pub/update/charity/22/cba/cba-letter-22July2022.pdf>
- For further resources, see www.carters.ca

Questions?