

 <p>BARRISTERS SOLICITORS TRADEMARK AGENTS</p>	<p>Carters Annual <i>Charity & Not-for-Profit Law</i> Webinar November 9, 2023</p>
<p>Donor Advised Funds: What You Need to Know in 2023</p> <p>By Jacqueline M. Demczur, B.A., LL.B. jdemczur@carters.ca 1-877-942-0001</p> <p>© 2023 Carters Professional Corporation</p>	
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<p>INTRODUCTION & OVERVIEW</p> <ul style="list-style-type: none">• There continues to be lots of interest in donor-advised funds (“DAFs”) throughout the charitable sector - from charities, donors, financial institutions/advisors and regulators, e.g. Canada Revenue Agency (“CRA”)• So it is timely to again review current DAF issues• A more detailed review of DAFs is set out in my paper, “<i>Primer on Donor Advised Funds and Current Issues – Revisited</i>”, May 15, 2023 https://www.carters.ca/pub/seminar/charity/2023/Paper-Primer-on-Donor-Advised-Funds-and-Current-Issues-Revisited-2023-05-12.pdf• This presentation will review:<ul style="list-style-type: none">- What are DAFs and Why are They so Popular?- What a DAF is at Law, including Recent Case Law?- Survey of Current Legal Issues Related to DAFs- Practical Considerations when Working with DAFs	
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A. CONTEXT OF DAFS – WHAT IS A DAF?

- A DAF is a type of charitable giving vehicle, established when a fund is created by a donor through an initial donation to a registered charity (“DAF Holding Charity”)
- The gifts by the donor (usually single person or family) to the DAF are irrevocable, and charitable donation receipts are issued for them by the DAF Holding Charity
- The DAF Holding Charity then gifts amounts from a DAF (which could include capital if the DAF is not perpetually endowed, as well as income) to either:

– Qualified donees (e.g. registered charities), or

– Grantee organizations (subject to the new qualifying disbursement rules)

- In a DAF, the donor is given the unique role of making non-binding suggestions to the DAF Holding Charity regarding the distribution of assets from the DAF to qualified donees or grantee organizations
- Despite donor advice, all administrative, operational and governance matters (including compliance with *Income Tax Act* [“ITA”] and CRA policies) are the **sole responsibility** of the DAF Holding Charity
 - This is because DAFs are the property of the DAF Holding Charity alone, **not** the donor
- Failure by a DAF Holding Charity to properly hold and maintain DAFs in compliance with tax/trust law could erode donor confidence and result in potential liability and credibility damage for the Charity

B. WHY ARE DAFs SO POPULAR NOW?

- DAFs are a practical and appealing alternative for donors who do not have the ability, interest or time to operate their own private foundations
- Relatively inexpensive to establish a DAF with a DAF Holding Charity versus operating a private foundation
- More anonymity and flexibility in structuring for donor

Some DAF Holding Charities do not impose minimum initial donations, or they can be as low as \$5,000, with ongoing fees also being moderate

Private foundations (unless established to facilitate flow through donations to qualified donees) are generally established with at least a \$1-\$2 million capital asset base, with ongoing annual operational costs

C. WHAT IS A DAF AT LAW?

1. It is a charitable gift

- A voluntary transfer of property owned by a donor to a donee, for which the donor receives no consideration

2. It could also be a donor restricted charitable gift

- Unrestricted charitable gifts must be applied to a charity's charitable purposes, but no donor restrictions
- Restricted charitable gifts are subject to restrictions imposed by the donor from the outset, which constrain or limit a charity's use of the gift in the future

3. It can be a gift for income tax purposes

- CRA accepts the common law definition of a gift
- A gift meeting all ITA requirements can be receipted

D. HOW DOES THIS ALL RELATE TO A DAF?

- Original gift from the donor establishing a DAF in a DAF Holding Charity could be unrestricted or it could be subject to one or more donor restrictions, e.g. how long capital to be held, what income to be used for, etc.
- DAFs will then have a donor-advised “feature” added to the gift, providing donor (and possible successor “fund advisors”) with ability to offer ongoing advice to the DAF Holding Charity on aspects of the DAF
 - However, this donor advised feature does not impose a legal obligation on DAF Holding Charity to act as the donor directs, although there is a moral obligation for the Charity to consider these suggestions

- A DAF Holding Charity must clearly inform its donors from the outset that their advice/input/suggestions are advisory only and all decisions related to the DAF are ultimately made by the Charity
 - This is imperative so that all DAF donations are true gifts at law and can be properly receipted under ITA
 - This reflects that the DAFs is the Charity’s own charitable property over which it must exercise ongoing direction and control
 - If there is excessive on-going control by the donor over the gifted property, it may lead to the CRA considering the gift to be defeated or negated

The Joseph Lebovic Charitable Foundation v Jewish Foundation, 2022 ONSC 4012 (“Lebovic Case”)

- After the death of the original DAF donor, the donor’s brother assumed responsibility as the DAF’s fund advisor with the Jewish Foundation of Greater Toronto (“JFGT”)
- Brother brought motion to prevent JFGT from spending a small portion of funds from the DAF contrary to his requests
- Court found the brother lacked grounds for his motion – stating that unless restrictions are imposed at the time a gift is made, a donor is not able to later direct how any charitable gifts are spent by the recipient charity

E. CURRENT ISSUES ASSOCIATED WITH DAFS

1. Disbursement-Related Issues – “Languishing” Assets in DAFs

- The 2019 Report of the Special Senate Committee on the Charitable Sector recommended that consideration be given to:
 - “means of ensuring that donations do not languish in donor-advised funds, but are instead used to fund charitable activities in a timely fashion.”
- This recommendation has been criticized conflating DAFs in Canada with certain features of US DAFs
- DAFs in the US can be used as a loophole for private foundations to avoid minimum payout requirements

- However, in Canada, there are:
 - Annual disbursement quota requirements, being the minimum calculated amount that a registered charity is required to spend each year (please see next slide)
 - Inter-charity transfer rules which prohibit transfers between non-arms' length charities for the purpose of avoiding minimum payout obligations
- Given these requirements, it is not clear why specific concerns about DAFS languishing are being raised in the Canadian context
- As a comparison, endowments and other restricted gift agreements provide donors with immediate tax benefits while asset distribution takes place over time

2. Disbursement Quota (“DQ”) Increase as of January 1, 2023

	Property* in excess of \$25,000 (foundations) or \$100,000 (charitable orgs) up to \$1 million	Property* in excess of \$1 million
DQ Rate	3.5%	5%

- However, a DAF Holding Charity meets its DQ obligations in any given year on **an aggregate basis**, not a **fund-by-fund** basis
- Some have questioned if individual DAFs should be required to disburse sufficient income each year
- Meeting new 5% DQ could be challenge for charities with endowments or other restricted funds – may need costly court order to be able to encroach on capital or realized capital gains

* “Property” refers to the value of a charity’s property not used for charitable activities or administration

- In Canada, it is estimated that only 10% of DAFs hold assets over \$1 million
 - So if a DQ were in theory imposed at an individual DAF level (not aggregate), a DAF Holding Charity would have lower overall DQ obligation given 3.5% DQ rate for assets under \$1 million, but would result in excessive administrative costs
- Average granting rate from DAFs in 2021 was 9.8% of assets, which is well in excess of the 5% DQ imposed on amounts above \$1 million (2023 CAGP Report)
- Bill C-32 also provides that (1) admin and management expenses cannot satisfy DQ obligations (2) charities can apply for reduction in DQ obligations but this could be made public
- T3010s may be amended by CRA in the future to gather more DAF related information, but not clear what information will be solicited or when such changes will be implemented

3. Qualifying Disbursements – Gifts to Grantee Organizations

- ITA was amended effective June 2022 to allow registered charities to make qualifying disbursements to grantee organizations if 3 requirements are met:
 - a) the disbursement furthers one of its charitable purposes
 - b) the disbursement is exclusively applied to charitable activities to further its own charitable purposes
 - c) documentation is maintained to demonstrate (a) and (b)
- DAF Holding Charities with sole charitable purpose of making gifts to qualified donees cannot make gifts to grantee organizations - a new charitable purpose(s) will be required, which takes time, money and regulator approval
- Draft CRA Guidance imposes additional requirements: (1) focus on risk matrix and (2) accountability tools
- Still waiting for final CRA Guidance
- See “New Qualifying Disbursement Regime for Charities: What Does it Mean in Practice?” presentation by Terrance Carter for more details

4. Anti-Directed Giving Provision

- Paragraph 168(1)(f) of the ITA states that a registered charity that accepts a gift “the granting of which was expressly or implicitly conditional” on it making a gift to “another person, club, society, association or organization other than a qualified donee” may have its registered charitable status revoked
- Not clear what is meant by “implicitly conditional”
- Could a donation to a DAF followed by a donor request a gift be made from the DAF to a local non-profit organization as a qualifying disbursement trigger this provision?
- Need further clarity in the legislation and future CRA guidance(s)
- See “New Qualifying Disbursement Regime for Charities: What Does it Mean in Practice?” presentation by Terrance Carter for more details

5. Impact of Alternative Minimum Tax

- Budget 2023 proposed alternative minimum tax (“AMT”) changes, *i.e.* alternative method to calculate income tax liability for high income individuals so that they pay higher tax than would pay under “regular” tax rules
- Key proposed changes: (1) 30% of capital gains on donations of publicly listed securities included in the AMT (currently not included) (2) 50% of donation tax credits (among others) will not reduce AMT payable
- If changes become law, they take effect January 1, 2024 - could impact high net-worth donors’ giving patterns, *e.g.* significant donations to DAFs following special events, such as property or business sales with substantial capital gains
- See “Alternative Minimum Tax and New Trust Reporting Rules for Charities” presentation by Theresa Man for more details

6. Uncertainty of New Trust Reporting Rules

- A DAF (and all donations made to it) may be donor-restricted charitable gifts held in trust by the DAF Holding Charity
- The addition of subsection 150(1.2) to the ITA, in effect for taxation years ending after December 30, 2023, may require some DAFs to file “T3s” as internal express trusts of a charity
- While CRA’s long-standing administrative policy is not to require charities to obtain separate charitable status for their internal express trusts
- It is unclear what information it may now expect charities to file re: these “express” trusts
- See “Alternative Minimum Tax and New Trust Reporting Rules for Charities” presentation by Theresa Man for more details

7. Importance of Granting Policies

- Need to ensure DAF gifts made to qualified donees are not offside of the ITA which could result in complaints, audits and/or penalties and sanctions
- Some DAF Holding Charities place limitations on the type of qualified donees able to receive gifts from their DAFs, e.g. geographic, religious, cultural/philosophical or program-based
 - Make all of these restrictions clear to donors in granting policy or guidelines, which should then be cross-referenced in the DAF agreement itself
- But not enough to have such a granting policy, there also needs to be ongoing monitoring and enforcement by the DAF Holding Charity

8. Successor Fund Advisors of DAFs

- A DAF Holding Charity may receive recommendations about gifts from the DAF from successor fund advisors
- Where the DAF agreement is silent, a donor’s attorney (under power of attorney) or executor may have ability to act as successor fund advisor
- The DAF agreement (or cross-referenced policies in the agreement) should address various scenarios:
 - What to do if donor does not designate a successor
 - How many successor fund advisors can be appointed
 - Multiple successors giving contrary recommendations
 - Whether successor fund advisors must only be individuals, e.g. not a corporation or a group of unrelated people

9. Impact of “Anonymous” Donations from DAFs

It is possible for donors to a DAF to remain anonymous when the DAF Holding Charity subsequently makes a gift to a charity out of that DAF

The recipient charity may find it difficult to keep the donor informed about the effectiveness of the DAF gift

The recipient charity may also not have the information it needs to determine if it should decline the gift (e.g. because of concerns about foreign interference or conflicts of interest)

F. PRACTICAL ADVICE FOR CHARITIES WITH DAFs

- **Do your homework**
 - Do due diligence so that your charity knows how to manage DAFs correctly based on trust/tax law
- **Create templates**
 - Develop and implement written gift acceptance and granting policies for DAFs and other gifting vehicles
 - Prepare template DAF agreements of various kinds
- **Ensure your charity runs the process**
 - Your charity – not the donor or their legal counsel – should be in control in establishing DAFs, utilizing consistent procedures as set out in the gift agreements and all related policies

- **Be Vigilant**
 - Avoid language suggesting that (1) DAFs belong to the donor, (2) donors are “clients” with “accounts” and (3) a DAF is a donor’s own private foundation
- **Identify Opportunities**
 - DAFs represent opportunities for ongoing connection and engagement with donors
 - DAFs could also be a new way for a charity to attract more gifts and potentially larger ones from donors
 - Donors may appreciate the flexibility of DAFs
 - A DAF could be structured so that the donor advice could request gifts be made to different programs within the charity from one year to the next

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