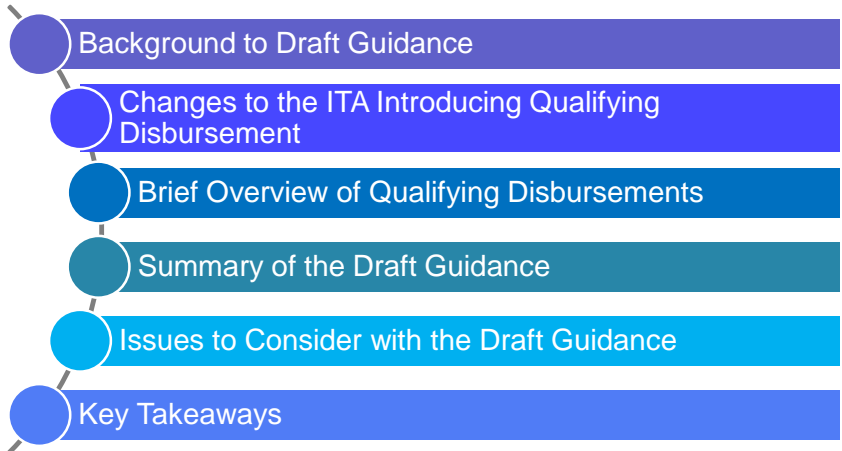





 <p>BARRISTERS SOLICITORS TRADEMARK AGENTS</p>	<h2>Carters Spring Charity and Not-for-Profit Law Webinar</h2> <p>March 2, 2023</p>		
<h3>CRA Draft Guidance on Qualifying Disbursements: A Work in Progress</h3> <p>By Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent tcarter@carters.ca 1-877-942-0001</p> <p>© 2023 Carters Professional Corporation</p> <table border="0"><tr><td data-bbox="259 833 645 882">CARTERS PROFESSIONAL CORPORATION TOLL FREE: 1-877-942-0001</td><td data-bbox="652 833 1209 882">Toronto Ottawa Orangeville <a href="http://www.carters.ca">www.carters.ca</a> <a href="http://www.charitylaw.ca">www.charitylaw.ca</a> <a href="http://www.churchlaw.ca">www.churchlaw.ca</a></td></tr></table>		CARTERS PROFESSIONAL CORPORATION TOLL FREE: 1-877-942-0001	Toronto Ottawa Orangeville <a href="http://www.carters.ca">www.carters.ca</a> <a href="http://www.charitylaw.ca">www.charitylaw.ca</a> <a href="http://www.churchlaw.ca">www.churchlaw.ca</a>
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2
<h2>OVERVIEW</h2>  <ul style="list-style-type: none"><li>Background to Draft Guidance</li><li>Changes to the ITA Introducing Qualifying Disbursement</li><li>Brief Overview of Qualifying Disbursements</li><li>Summary of the Draft Guidance</li><li>Issues to Consider with the Draft Guidance</li><li>Key Takeaways</li></ul> <ul style="list-style-type: none"><li>For more detailed commentary, please see Carters <i>Charity and Not-for-Profit Bulletins 519 and 518</i>, and see as well the submission by the <a href="#">Canadian Bar Association to the CRA</a> dated February 6, 2023</li></ul> <p><a href="http://www.charitylaw.ca">www.charitylaw.ca</a> <span style="float: right;"><a href="http://www.carters.ca">www.carters.ca</a></span></p>





3

## A. BACKGROUND TO DRAFT GUIDANCE

-  Charitable sector expressed concerns about the many problems with the CRA's "own activities" and "direction and control" regime
-  Reforms were proposed through Bill S-216 and an anticipated standard of "resource accountability" rather than a requirement of direction and control
-  Budget 2022 purported to make amendments to the *Income Tax Act* (ITA) in the "Spirit of Bill S-216"
-  Bill C-19 (Budget Implementation Act, 2022, No. 1) introduced "qualifying disbursements" that charities can make to "grantee organizations"
-  In its original form, Bill C-19 included proposed onerous regulations, especially with regards to required documentation for qualifying disbursements

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4

-  Lobbying by the charitable sector resulted in the removal of the onerous regulations from Bill C-19 in June 2022 prior to the Bill receiving Royal Assent
-  The CRA Draft Guidance "Registered charities making grants to non-qualified donees" was released on November 30, 2022
-  The deadline for comments on the Draft Guidance was January 31, 2023
-  The Draft Guidance will likely change before it is finalized some time later in 2023

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5

## B. CHANGES TO THE ITA INTRODUCING QUALIFYING DISBURSEMENT

- On June 23, 2022, Bill C-19 amended the ITA to allow charities to make qualifying disbursements (disbursements by way of a “gift or otherwise making resources available”) to qualified donees or to “grantee organizations” (organizations that are not qualified donees, e.g. not registered charities) if:
  - (i) the disbursement is in furtherance of a charitable purpose of the charity,
  - (ii) the charity ensures that the disbursement is exclusively applied to charitable activities in furtherance of a charitable purpose of the charity, and
  - (iii) the charity maintains documentation sufficient to demonstrate (i) and (ii)
- The Draft Guidance focusses mainly on (iii) above i.e. documentation required for qualifying disbursements to non-qualified donees

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6

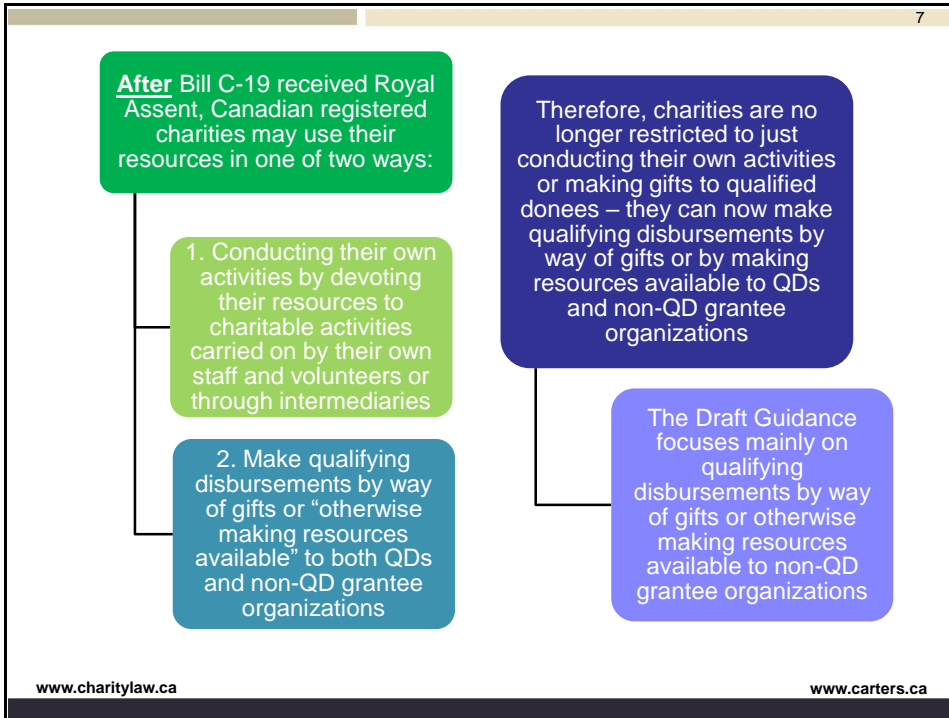
## C. BRIEF OVERVIEW OF QUALIFYING DISBURSEMENTS

**Before** Bill C-19 received Royal Assent, Canadian registered charities could only use their resources in one of two ways:

1. Conducting their own activities by devoting their resources to charitable activities carried on by their own staff and volunteers or through intermediaries
2. Making gifts to qualified donees “QDs”

If a charity wanted to work with an organization that was not a QD, it had to demonstrate that it was conducting its own activities by exercising direction and control over the non-QD organization concerning how it utilized any funds or other resources provided by the charity

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8

## D. SUMMARY OF THE DRAFT GUIDANCE

### 1. Sections 1-3: Introduction, Definitions and General Requirements

- Definitions from the Draft Guidance:
  - **“charity”** includes all three types of registered charities: charitable organizations, public foundations, and private foundations, and also includes applicants for registration
  - **“grants”** refers to transfers of both monetary and non-monetary resources, or otherwise making resources available, to a non-qualified donee (grantee)
  - **“grantee”** is a non-qualified donee and is defined in the *Income Tax Act* to include “a person, club, society, association or organization or prescribed entity, but does not include a qualified donee”. A grantee is an individual or organization that the charity works with to further its charitable purposes

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9

- Explains how “granting” differs from “own activities (“direction and control”) regime, e.g.
  - relationship with grantee can be a collaboration, rather than hierarchical
  - allows the grantee autonomy to carry on its own programs
  - the charity can support the existing activities of the grantee
  - does not need to exercise “direction and control” over charity’s “own activities”
  - focus on risk and accountability rather than “own activities”
- Charity can continue to carry on its “own activities” through an intermediary using direction and control, if it wishes
- A charity may convert its relationship with a grantee (e.g. from direction and control to a grant) but must note this change in its books and records, presumably with an explanation of why
- Charity needs to clearly show in its books and records when it is making a grant and when it is exercising direction and control

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10

## 2. Sections 4-6: Making Grants to Grantees and Accounting Requirements

- The Draft Guidance indicates that the CRA recommends the following steps in the grant making process to meet accountability requirements in the ITA:
  - Establish how the grant furthers the charity’s charitable purposes
  - Assess the grant’s overall risk level: high, medium, or low risk
  - Consider the accountability tools that the CRA recommends the charity implement, based on the grant’s risk level
  - Determine how to apply the accountability tools to mitigate risk and meet the accountability requirements

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- Accountability requirements may be met in the grant making process by:
  - assessing risks involved with the grant by referring to the risk matrix chart of low, medium and high risk
  - identifying accountability tools to combat the risk, including due diligence review, description of grant activity, written agreements, monitoring and reporting, transfer schedules and separately tracked funds
  - applying the accountability tools so identified, with the Draft Guidance providing a detailed description of each
- A charity making a grant must maintain adequate books and records to allow the CRA to determine if there is compliance
  - charity should be able to obtain from the grantee any grant documents in original or electronic format
  - failure to keep adequate books and records exposes the charity to sanctions, including revocation

### 3. Section 7: Special Topics

The last section of the Draft Guidance goes over several “special topics” that are related to grant making, consisting of:

- Anti-terrorism Considerations – charity must not support terrorist activities by making a grant to an individual or group engaged in or supporting terrorist activities – refers to [CRA checklist for Charities avoiding terrorist abuse](#)
- Directed Donations and Acting as a Conduit (described below)
- Pooled Grants (described below)
- Granting Charitable Goods (described below)
- Reporting Grants in the T3010 Registered Charity Information Return for each grantee receiving grants in excess of \$5,000 – charity must show the purpose and total amount of each grant, as well as the name of grantees
- Granting of Real Property (e.g., land or buildings) – this is considered high risk and the charity must have adequate documentation to ensure that property will be used only for charitable activities that further its charitable purpose

## E. ISSUES TO CONSIDER WITH THE DRAFT GUIDANCE

### 1. Confusing Defined Terms of “Grants” and “Grant Making”

- The Draft Guidance states that it focuses “on making grants to grantees”, but the terminology of “grants”, “grant making” and “grantees” are not terms that are used in the ITA
- The ITA uses the terms “qualifying disbursements” and “grantee organizations”

Language in Draft Guidance	Language in ITA
“grant” refers to <u>transfers</u> of both monetary and non-monetary resources, or otherwise making resources available, to a non-qualified donee (grantee).	<u>qualifying disbursement</u> means a <u>disbursement</u> by a charity, by way of a <u>gift</u> or by <u>otherwise making resources available</u> to a qualified donee, or a grantee organization

- Courts expect charities to comply with legislation as opposed to tax guidance, so these differences could have significance

### 2. Imposition of Extensive Additional Requirements

- **Focus on Risk Matrix**
  - “risk” is mentioned 62 times in the Draft Guidance but is not mentioned at all in s 149.1 of the ITA
  - no indication of what the “risk” is that is to be avoided, so it is difficult to know how to assess risk factors
  - risk matrix says that grants outside Canada and over \$25,000 are high risk but no explanation is provided to explain why \$25,000 is a high risk threshold
  - risk matrix is very similar to US Treasury Risk Matrix for purpose of anti-terrorist financing avoidance under US law
- **Accountability Requirements and Tools**
  - “accountability” is mentioned 46 times in the Draft Guidance but is not mentioned at all in s 149.1 of the ITA
  - Suggested accountability tools are similar to the requirements for “expenditure responsibility” for US private foundations
  - the accountability tools are similar to the requirements in proposed ITA regulations that were removed from Bill C-19.

- **Pooled Grants**
  - Before a charity can make a pooled grant with a non-qualified donee, it will be expected to have in place significant documents, including **written agreements** (“ideally”, or if not feasible, then document reasons why not feasible in books and records), and **interim and final reports** (clearly showing that resources were used in furtherance of charity’s purposes)
  - Otherwise, the Draft Guidance recommends approaching pooled grants cautiously
  - In light of this, will many charities want to make pooled grants?
- **Charitable Goods**
  - charitable goods (*i.e.* goods that can only reasonably be used for charitable purposes, such as medical supplies) will be subject to specific “accountability tools”, including written agreements and final reports on how goods were used
  - these requirements are more onerous than for “charitable goods” under the direction and control regime in CG-002

### 3. Unclear Explanation of “Otherwise Making Resource Available”

- The ITA clearly indicates that a charity can make “gifts” to non-QDs and can also “otherwise or “mak[e] resources available” to non-QDs
- The Draft Guidance makes reference to charities “transferring” monetary and non-monetary resources but does not use the phrase “otherwise making resources available” except in the initial definition of “grant”
- It is not clear whether the concept of “transferring” non-monetary resources in the Draft Guidance is intended to mean:
  - (a) the charity is gifting non-monetary resources to a non-QD, or
  - (b) the charity is making available non-monetary resources to a non-QD, such as use of space, staff, administration services, volunteers, or use of branding
- This will be important when preparing agreements needed in order to make a “grant” to a non-QD



## 4. Some Qualifying Disbursements do not Meet Disbursement Quota Obligations

The Draft Guidance does not mention the disbursement quota (“DQ”) or address how qualifying disbursements are treated for purposes of meeting the QD

Only qualifying disbursements that are gifts can be used to meet the DQ obligations of the granting charity  
 – many charities may find this confusing to track or difficult to comply with in light of the increased DQ of 5% for certain property in excess of \$1 million

Qualifying disbursements made by “otherwise making resources available” to either QDs or non-QDs will not be counted towards the DQ, which would include making space or staff available, as well as making micro-finance loans and other types of impact investing

## 5. Does not Reflect ITA Wording About Directed Gifts

- Paragraph 168(1)(f) of the ITA states that the CRA can revoke a charity’s charitable registration if it accepts a gift “the granting of which was expressly or implicitly conditional on the charity [...] making a gift to another person, club, society, association or organization other than a qualified donee”
  - Such a gift is generally referred to in the Draft Guidance as a “directed donation”
- The Draft Guidance states that paragraph 168(1)(f) of the ITA is “intended to prevent a charity from acting as a conduit” but does not provide an explanation regarding:
  - What it considers a “conduit” to be, or
  - How the ideas of “directed donations” and “conduits” are related
- It is also not clear in the Draft Guidance under what circumstances a charity will be considered to have made an express or implicit conditional gift, since conditional gifts have particular meaning at common law and the wording in the ITA will take precedent over the Draft Guidance

## 6. Does not Address Charitable Purposes of Charities that only Make Gifts to Qualified Donees

- The Draft Guidance does not address how charities that have a single charitable purpose of making gifts to qualified donees may make qualifying disbursements to non-qualified donees
- Since qualifying disbursements need to be made to non-qualified donees “in furtherance of a charitable purpose of the charity,” it means that passive funding charities will not be able to make qualifying disbursements to grantee organizations because to do so would not further their charitable purpose
- It would be helpful if the Guidance would include sample wording of charitable purposes that could be used by charities in order to make qualifying disbursements

## F. KEY TAKEAWAYS



The introduction of qualifying disbursements in the ITA represents a very important change in the law for charities in Canada, and a finalized Guidance from the CRA will set the standard for the approach charities will need to take in applying these recent amendments to the ITA



In the short term, charities will want to exercise caution and consult with their legal counsel before relying on the Draft Guidance in planning how to make qualifying disbursements



Hopefully, the CRA will carefully consider the feedback received from the charitable sector in looking to make the final version of the Guidance truly in “the spirit of Bill S-216”



[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, 2022), 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 former 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.

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