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Association of Treasurers of Religious Institutes

September 30, 2023

CRA's New Qualifying Disbursement Regime

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- For a more detailed commentary see the *Charity & NFP Law Bulletin No. 519* and Carters presentation, *CRA Draft Guidance on Qualifying Disbursements: A Work in Progress* dated March 2nd, 2023 on www.carters.ca
- Information is current as of September 27, 2023, but subject to change






A. SETTING THE STAGE

- Many religious institutes from time to time may need to work with other organizations, whether they be juridical persons or otherwise, in order to achieve their charitable purposes
- This may also involve the transfer of legacy assets, including when there is a merger or suppression of a religious institute in Canada
- When those other organizations are Canadian registered charities or other types of qualified donees listed under the *Income Tax Act* (ITA), (for example, registered foreign universities, municipalities in Canada, municipal and public bodies performing a function of government in Canada, *etc.*), then for income tax purposes this will not be an issue because a religious institute as a Canadian registered charity is able to make gifts to other qualified donees
- However, when a religious institute is having to work with an organization that is not a qualified donee under the ITA, like a Generalate or a Provincialate in another country, then compliance requirements by the religious institute as a registered charity in Canada can become challenging

- Until June 23, 2022, religious institutes as Canadian registered charities, could transfer monies or other resources to organizations that were not qualified donees (“non-qualified donees”) generally in one of three ways:
 - 1) Payment of invoices for specific goods and services at fair market value or below, *e.g.* reimbursement of airfare to fly a Superior to Canada;
 - 2) Payments to non-qualified donees as intermediaries under the existing Own Activities/ Direction & Control Regime described in more detail below through CRA approved relationships of agency, joint venture, co-operative participants, consultants or contracts
 - 3) Reoccurring payments, such as tithes, membership fees, or “annual tax” by a Canadian religious institute in consideration of receiving ongoing value in the form of services from a Generalate or Provincialate in excess of the *de minimis* amount that Canadian charities are able to pay to their head bodies (*i.e.* the lesser of 5% of the charity's total expenditure in the year and \$5,000) pursuant to a head body agreement

- Now, as a result of amendments to the ITA in June 2022, there is another option of making qualifying disbursements to non-qualified donees in the form of either a “gift” or “otherwise making resources available” as discussed below
- This presentation explains the following:
 - What the new Qualifying Disbursement Regime involves
 - How the new Qualifying Disbursement Regime compares to the existing Own Activities/ Direction & Control Regime (“Own Activities Regime”)
 - Some practical comments on how to navigate the new Qualifying Disbursement Regime for those religious institutes that may want to consider this option
- The slides that follow are technical at times because the option of utilizing the Qualifying Disbursement Regime involves numerous complex factors that need to be considered before proceeding

B. BACKGROUND TO THE NEW DISBURSEMENT QUOTA REGIME

-  Charitable sector had expressed concerns for years about the many problems with the CRA’s Own Activities Regime
-  Reforms were proposed through Bill S-216 by Senator Omidvar 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 the “Qualifying Disbursement Regime”
-  In its original form, Bill C-19 included proposed onerous regulations, especially with regards to required documentation for qualifying disbursements

- 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 (“Draft Guidance”)
- The deadline for comments on the Draft Guidance was January 31, 2023
- The Draft Guidance will invariably change before it is finalized some time later in 2023
- Comments about the Draft Guidance in this presentation are based upon those portions of the Draft Guidance that may continue in some form in the final version of the Guidance

C. BRIEF EXPLANATION OF THE DISBURSEMENT QUOTA REGIME

1. Before Bill C-19 Amended the ITA on June 23, 2022

Canadian registered charities could only use their resources in one of two ways under the ITA:

1. Conducting their own activities by devoting their resources to charitable activities carried on by their own staff and volunteers or through intermediaries under direction and control

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

2. Bill C-19 Introduced the Option of Qualifying Disbursement Regime

ss. 149 (1) of ITA “*qualifying disbursement* means a disbursement by a charity, by way of a gift or by otherwise making resources available,

- (a) subject to subsection (6.001), to a qualified donee, or
- (b) to a **grantee organization**, if
 - (i) the disbursement is in furtherance of a charitable purpose (determined without reference to the definition charitable purposes in this subsection) 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
 - (A) the purpose for which the disbursement is made, and
 - (B) that the disbursement is exclusively applied by the grantee organization to charitable activities in furtherance of a charitable purpose of the charity;”

“**grantee organization**” includes a person, club, society, association or organization or prescribed entity, but does not include a qualified donee;

3. After Bill C-19 Became Law on June 23, 2022, Canadian Registered Charities Now Have Two Regimes to Choose From:

1. Conducting their own activities by devoting their resources to charitable activities carried on by their own staff and volunteers or through intermediaries under direction and control

2. Make qualifying disbursements by way of gifts or “otherwise making resources available” to both QDs and non-QD grantee organizations

Therefore, charities are no longer restricted to just conducting their own activities or making gifts to qualified donees – they can now make qualifying disbursements by way of gifts or by making resources available to QDs and non-QD grantee organizations

The Draft Guidance focuses on qualifying disbursements by way of gifts or otherwise making resources available to non-QD grantee organizations

D. OVERVIEW OF CRA 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

- Explains how “granting” under the Qualifying Disbursement Regime differs from “direction and control” under the Own Activities 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 to
- 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

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 by utilizing a detailed risk assessment matrix
 - Consider the accountability tools that the CRA recommends the charity implement, based on the grant’s risk level, including evaluation of the history, reputation, staff and volunteers of the grantee
 - Determine how to apply the accountability tools to mitigate risk and meet the CRA’s accountability requirements

- 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

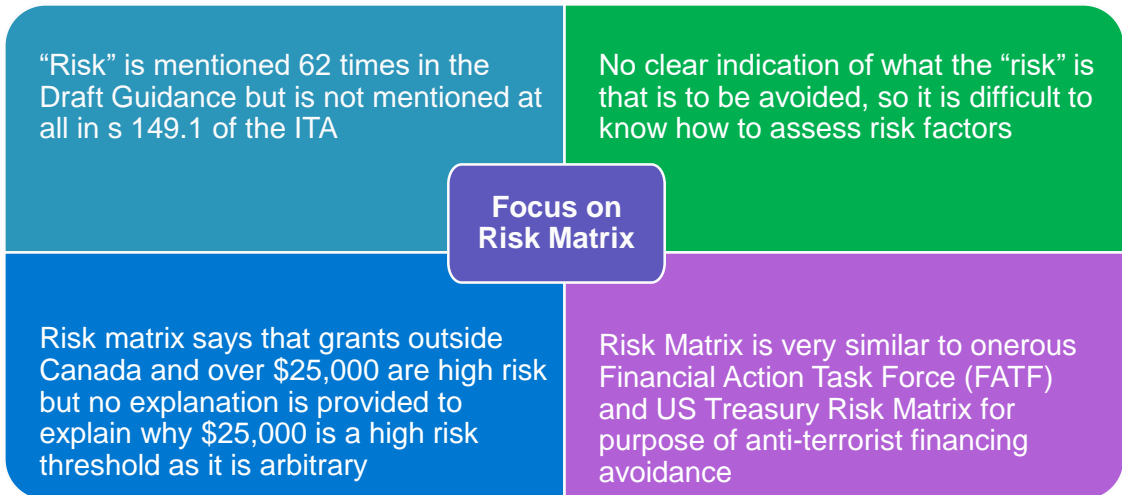
- The last section of the Draft Guidance goes over several “special topics” that are related to grant making, consisting of:
 - Anti-terrorism Considerations – charity must not support terrorist activities by making a grant to an individual or group engaged in or supporting terrorist activities – refers to CRA checklist for Charities avoiding terrorist abuse
 - Directed Donations and Acting as a Conduit (described below)
 - Pooled Grants with Multiple Organizations (described below)
 - Granting Charitable Goods (described below)
 - Reporting Grants in the T3010 Registered Charity Information Return (described below)
 - Granting of Real Property (e.g., land and 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 QUALIFYING DISBURSEMENTS

1. Need to Review Charitable Purposes of the Charity

- A qualifying disbursement is all about furthering the charitable purpose of the donor charity and cannot be done if it is outside of the donor charity's charitable purposes
- Therefore, it is essential to review the charitable purposes of the donor charity before considering making a qualifying disbursement
- Foundations that have only a single purpose of making gifts to QDs will not be able to make qualifying disbursements to grantee organizations since grantee organizations are not QDs
 - Therefore, foundations with a single purpose of only making gifts to QDs will need to review and update their charitable purposes if they are intending to make Qualifying Disbursements
 - It will be important to see if the final form of the Guidance will provide a simplified process to do so

2. Imposition of Extensive Additional Requirements



• Accountability Requirements

- “Accountability” is mentioned 46 times in the Draft Guidance but is not mentioned at all in section 149.1 of the ITA
- Suggested accountability tools are similar to the requirements for “expenditure responsibility” for US private foundations and are therefore complicated
- The accountability tools are similar to the requirements in proposed ITA regulations that were removed from Bill C-19 so they should not apply
- Hopefully, the final form of the Guidance will have a less onerous approach to the issue of “accountability”\
- However, there would appear to be more onerous requirements of accountability with the Qualified Disbursement Regime as described, in the Draft Guidance than there is with the Own Activities Regime

- **Pooled Grants with Multiple Organizations**
 - Before a charity can make a pooled grant with one or more non-qualified donees, 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
- **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 CRA’s CG-002 Guidance

3. Confusing Defined Terms of “Grants” & “Grant Making”

- The Draft Guidance states that it focuses “on making grants to grantees”, but the terminology of “grants” and “grant making” 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 means a 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 a CRA guidance, so these differences are important to keep in mind as they could have significance on a CRA audit that was subsequently reviewed by a court

4. Unclear Explanation of “Otherwise Making Resources Available”

- The ITA clearly indicates that a charity can make “gifts” to non-QDs as well as “otherwise making resources available” to non-QDs but does not explain what the phrase “otherwise making resources available” means in practice
- 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 uncertainty will be important to consider when preparing agreements needed in order to make a “grant” to a non-QD

5. Some Qualifying Disbursements Do Not Meet Disbursement Quota Obligations

- The Draft Guidance does not mention the disbursement quota (“DQ”) or how qualifying disbursements are treated for purposes of meeting the DQ
- Only qualifying disbursements that are gifts to QDs and non QDs 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 investment 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 5% DQ, which means that making space, staff and volunteers available, as well as engaging in micro-finance loans and other types of impact investing are not DQable

Building Space

Staff & Volunteers

Micro-finance Loans

Impact Investing

6. Does not Reflect The Wording in ITA About Directed Gifts

- New 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"
 - e.g Charity A accepting a gift that is "expressly or implicitly conditional" on Charity A making a gift to Non-Charity B

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 any explanation concerning what it considers a "conduit" to be "conduits" are relate

- The Draft Guidance is also not clear what an express or implicit conditional gift is, since conditional gifts have particular meaning at common law
- The directed gift provision, though, does not appear to apply to a charity carrying out its own activities through an intermediary under the charities direction and control because it is not a "gift" to a non QD

F. Reporting Qualifying Disbursements

- A charity that makes a qualifying disbursement to a grantee will need to include on its annual T3010 the following information for each grantee organization that receives in excess of \$5,000 in the taxation year:

a) The name of the grantee organization;

b) The purpose of each qualifying disbursement; and

c) The total amount disbursed by the charity to each grantee organization

- The charity must be able to determine the fair market value of non-cash gifts that are made to grantees on its T3010
- In May 2023, the CRA updated the T3010 Registered Charity Information Return to report grants made to non-qualified donees
- It also introduced the new T1441 Qualifying Disbursements: Grants to Non-Qualified Donees requiring detailed information about these grants

- The T3010 asks:
 - If the charity has made qualifying disbursements via grants to non-qualified donees
 - If any of these grants totaled more than \$5,000 in cash and non-cash grants in one fiscal period
 - The number of grantees receiving grants totaling \$5,000 or less
 - The total amount paid to grantees totaling \$5,000 or less in a fiscal period
- The T1441, which records all grants individually, must include:
 - The number of grantees that received grants totaling more than \$5,000
 - Report each grant separately, even if it's to the same grantee
 - The name of the grantee
 - The purpose of the grant
 - The total amount of cash and non-cash disbursements separately
 - The country where grant activities were carried out, (unless permission is obtained due to safety concerns)
- The CRA has updated T4033, Completing Form T3010 Registered Charity Information Return, to assist charities in completing these forms

G. COMPARING THE DISBURSEMENT QUOTA REGIME TO THE OWN ACTIVITIES REGIME

- Since religious institutes as registered charities can now choose between the two regimes when working with non QDs, what are the differences?

Own Activities Regime	Qualifying Disbursement Regime
– Focus on the charity being the directing mind with an intermediary carrying out instructions received from the charity	– Focus on supporting the activities of the grantee organization in achieving its purposes, not those of the donor charity
– More of a hierarchical top down relationship	– More of a collaborative relationship of mutual co-operation and respect
– The funds or resources are not gifted, instead they are transferred to an intermediary as an extension of the charity by means of a contractual agreement	– The funds or resources are either gifted or are otherwise made available to the grantee and become the property of the grantee organization to use for its own programs
– The applicable regulatory due diligence is in the form of ongoing direction and control by the charity over the activities of the intermediary	– The applicable regulatory due diligence is in the form of applying a risk matrix and following extensive accountability requirement rather than providing ongoing direction and control

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Own Activities Regime	Qualifying Disbursement Regime
<ul style="list-style-type: none"> - An agreement is needed to reflect direction and control over own activities of the charity e.g. contract for service or co-operative participation 	<ul style="list-style-type: none"> - For qualifying disbursements above \$5,000.00, a grant agreement will be needed to address a significant degree of risk assessment and accountability requirements
<ul style="list-style-type: none"> - As the intermediary is acting as an extension of the charity under the direction and control of the charity, the charity could likely be exposed to liability by the intermediary 	<ul style="list-style-type: none"> - Since the grant involves giving the funds to a grantee organization to support programs of the grantee, the charity will be less exposed to liability risk
<ul style="list-style-type: none"> - Charitable programs done through an intermediary will count toward the disbursement quota of the charity 	<ul style="list-style-type: none"> - Qualifying disbursements in the form of "otherwise making resources available" will not count towards the disbursement quota of the charity
<ul style="list-style-type: none"> - Contracting with an intermediary to allow the intermediary to purchase land is subject to significant restrictions 	<ul style="list-style-type: none"> - Gifting of real estate needs to be carefully documented but is generally less restrictive
<ul style="list-style-type: none"> - Contracting with an intermediary in Canada "may" attract HST/ GST (need expert HST advice) 	<ul style="list-style-type: none"> - Making a qualifying disbursement to a grantee in Canada will not attract HST/GST
<ul style="list-style-type: none"> - Less onerous reporting requirements in T3010 	<ul style="list-style-type: none"> - More onerous reporting requirements in T3010

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H. SOME PRACTICAL CONSIDERATIONS TO KEEP IN MIND

1. Can a Charity Change Regimes?

- A charity can continue utilizing existing agreements under the Own Activities Regime but also undertake new projects in the future under the Qualifying Disbursement Regime
- A charity also can change from utilizing an agreement under the Own Activities Disbursement Regime to making qualifying disbursements with the same party as a grantee organization under the Qualifying Disbursement Regime
- The key factor is that the charity must be able to document its reason for using one of the two regimes and also have the necessary books and records to be able to evidence compliance with the applicable CRA Guidance that applies
 - CG-002 – Canadian registered charities carrying on activities outside of Canada
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-002-canadian-registered-charities-carrying-activities-outside-canada.html>
 - CG-032 – Draft Guidance for Registered charities making grants to non-qualified donees
<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/charities-making-grants-non-qualified-donees.html>

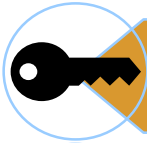
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2. Other Factors That a Charity Needs to Consider?

- Avoiding an unacceptable private benefit that exceeds what is considered to be charitable (e.g. the private benefit is necessary, reasonable and proportionate) when working with a grantee organization
- Avoiding activities that might be contrary to public policy in Canada, e.g. carrying out charitable programs in another country that are contrary to human rights legislation or the Criminal Code
- Avoiding undue risk to the charity by ensuring compliance with applicable laws in foreign jurisdictions
- Complying with Canadian *Anti-Terrorist Financing Act* and *Anti-Money Laundering Act* (See CRA's publication "*Charities in the International Context*" <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/charities-international-context.html>)

- For those charities directly or indirectly operating in Afghanistan or other countries/regions under the control of a terrorist group, there will need to be compliance with Canada's new Bill C-41 (June 2023) **be** either
 - complying with a blanket exemption for "humanitarian assistance activities" if specified conditions are met, or
 - applying for government authorization within certain specified exceptions
- See *Carters AML/ATF and Charity Alert No. 53* dated August 31, 2023 "A Practical Guide for Charities and Humanitarian Organizations to Bill C-41 and the Provision of Aid" for details <https://www.carters.ca/pub/bulletin/charity/2023/atcylb51.pdf>
- Ensuring compliance with anti-bribery and anti-corruption law in both Canada and in the foreign jurisdiction
- Ensuring adequate books and records are maintained as required by CRA under the ITA in order to be prepared for a CRA audit

I. KEY TAKEAWAYS



The new Qualifying Disbursement Regime is an important new option for religious institutes to consider



However, there are complexities and significant due diligence requirements that must be carefully reviewed before deciding to make a qualifying disbursement to a grantee organization



Whether or not a religious institute should embark on making a qualifying disbursement to a grantee organization or choose to continue with the Own Activities Regime is a decision that should be carefully reviewed with legal counsel for the religious institute



It is Important to stay tuned to see what the CRA will provide for in it's final form of the Guidance



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