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# CBA CHARITY LAW Symposium



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## Primer on Donor Advised Funds and Current Issues: Revisited

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## Introduction

- Interest in donor-advised funds (“DAFs”) has continued to accelerate
- It is timely to again review the context of and current issues in relation to DAFs
- This review has been done in an accompanying paper to this presentation, *“Primer on Donor Advised Funds and Current Issues – Revisited”*
- To be legally valid, DAFs must be properly established, held and maintained by registered charities (“DAF Holding Charities”) in compliance with tax/trust law
  - Failure to do so could erode donor confidence and expose DAF Holding Charities to potential liability, as well as damage these charities’ credibility



## 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 DAF Holding Charity
- The gift by the donor is irrevocable, and the donor receives a charitable donation receipt from the DAF Holding Charity in exchange for the gift
- The DAF Holding Charity 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 requirements for making qualifying disbursements to such organizations)

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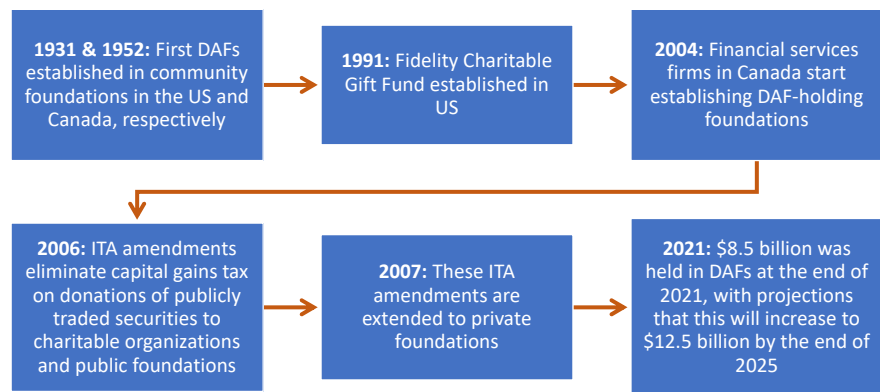
## Context of DAFs – What is a DAF?

- 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 this donor advice, all administrative, operational, and governance matters (including compliance with the *Income Tax Act* ["ITA"] and Canada Revenue Agency ["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

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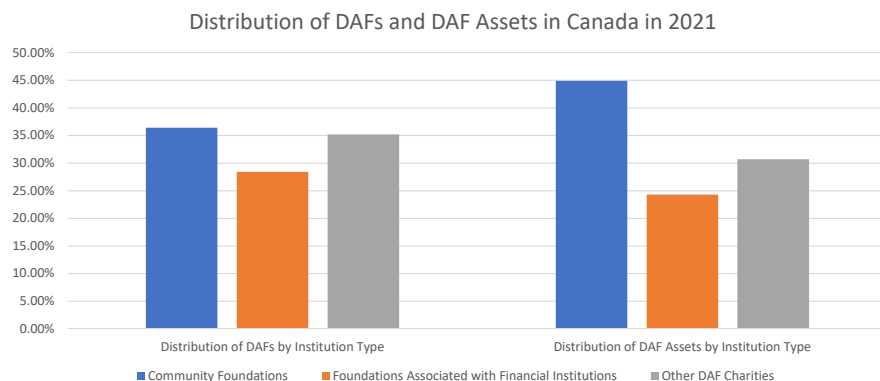
## History, Development and Current Size of DAFs



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## Distribution of DAFs and DAF Assets



\* Statistics from "Influence, Affluence & Opportunity: Donor-advised Funds in Canada" (paper delivered at the CAGP's 29th National Conference on Strategic Philanthropy, Vancouver BC, 19-21 April 2023) Ketchum Canada Inc. and Canadian Association of Gift Planners at p. 11-14 – Please see footnote 16 of the Primer paper accompanying this presentation for an explanation of the data presented in this chart.

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## Who are the Key Players in DAFs?

### a) Donors

- Donors are those who gift the assets to initially establish a DAF and who fund the DAF on an ongoing basis

### b) DAF Holding Charities

- Community Foundations: generally focussed on raising funds from donors in a particular geographic area
- Foundations established by or associated with financial institutions: often use the investment services of related financial institutions to invest capital amounts held in DAFs
- Other DAF Charities: a broad range of other organizations, e.g. various religious organizations, higher education institutions and hospitals

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## Who are the Key Players in DAFs?

### c) Qualified Donees and Grantee Organizations Receiving Gifts from DAFs

- Amounts given to grantee organization must meet requirements for “qualifying disbursements” as set out in ITA

### d) The CRA

- Regulator of registered charities and establishes policies for them, re: requirements for qualifying disbursements

### e) Others (e.g. Financial Advisors and Financial Institutions)

- Clients interested in establishing a DAF will often follow advice of their financial advisors on which charitable foundation to use
- Financial advisors may receive bonuses for these initial client referrals, as well as based on the ongoing amount of assets in the DAFs

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## Why are DAFs so Popular Now?

- DAFs may be 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 as compared to operating a private foundation

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

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## What is a DAF at Law?

### 1. What is a Charitable Gift?

- A voluntary transfer of property owned by a donor to a donee, for which the donor receives no consideration
- For *inter vivos* gifts (made during one's lifetime), a gift must fulfill three conditions: (1) gift is voluntary, (2) property is transferred, and (3) the donor cannot receive any benefit back for making the gift

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## What is a DAF at Law?

### 2. What is a Donor Restricted Charitable Gift?

- Unrestricted charitable gifts must be applied by a charity to its charitable purposes, but are not subject to donor restrictions
- Restricted charitable gifts are subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor from the outset
- These donor restrictions then constrain or limit a charity's use of the gift in the future

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## What is a DAF at Law?

### 3. What is a Gift for Income Tax Purposes?

- While the CRA has adopted the traditional common law definition of a gift, gifts for ITA purposes are not necessarily the same as gifts at common law. For example, under the ITA:
  - Gifted property cannot include, e.g., services, use of a timeshare
  - Split-receipting rules permit donors to receive some consideration in exchange for the donation
- Only gifts that meet ITA requirements can be properly receipted

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## What is a DAF at Law?

### 4. 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, alternatively, subject to one or more donor restrictions, e.g. how long capital to be held, what income to be used for
- DAFs then have a donor-advised “feature” added to the gift, providing donor with ability to offer ongoing advice to the DAF Holding Charity on aspects of the DAF
  - However, this donor advice 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

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## What is a DAF at Law?

*The Joseph Lebovic Charitable Foundation v Jewish Foundation,  
2022 ONSC 4012*

- After passing of the original DAF donor, his brother assumed responsibility as the DAF 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 – 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

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## What is a DAF at Law?

- 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 properly receipted as such under the ITA
  - This reflects that the DAFs is the Charity's own charitable property over which it must exercise direction and control
  - Excessive on-going control by the donor over the gifted properly may lead to the CRA considering the gift to be defeated or negated

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## Current Issues Associated with DAFs

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

- The Special Senate Committee on the Charitable Sector's 2019 Report 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 subject to some criticism for conflating DAFs in Canada with certain features of US DAFs

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## Current Issues Associated with DAFs

- DAFs in the US can be used as a loophole for private foundations to avoid minimum payout requirements
- However, in Canada, there is a disbursement quota and inter-charity transfer rules which prohibit transfers between non-arms' length charities for the purpose of avoiding minimum payout obligations
- It is not clear why specific concerns about DAFs languishing are being raised in the Canadian context
- Endowments and other restricted gift agreements similarly provide donors with immediate tax benefits while asset distribution takes place over time

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## Current Issues Associated with DAFs

### 2. Disbursement-Related Issues – Role of Financial Institutions in DAFs

- DAF Holding Charities associated with financial institutions have received particular scrutiny
  - This is because of suggestions that they are incentivized to keep DAF assets as long as possible (so as to continue to provide financial services to DAFs and receive fees associated with such services)
- DAFs held by these Charities may have lower flow rate (i.e. the relationship between donations received and grants made in any one period)
- However, this could be explained by increasing donations as financial advisors encourage their clients to engage in charitable giving

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## Current Issues Associated with DAFs

### 3. Disbursement-Related Issues – Impact of Disbursement Quota

	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%

- Whether a DAF Holding Charity is meeting its Disbursement Quota (“DQ”) obligation in any given year is calculated on an aggregate basis, as opposed to on a fund-by-fund basis
- Questions have been raised about whether the CRA should examine if individual DAFs disburse sufficient income each year

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

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## Current Issues Associated with DAFs

In Canada, it is estimated that only 10% of DAFs hold assets over \$1 million

This means that if a DQ was imposed at an individual DAF level (instead of on aggregate basis), it could result in a lower overall DQ obligation for the DAF Holding Charity given the 3.5% DQ rate for assets under \$1 million

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

Budget 2022 also proposed that T3010s be amended in the future to gather more information about DAFs, but it is not clear what information will be solicited or when these changes will be implemented

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## Current Issues Associated with DAFs

### 4. Qualifying Disbursements – Making 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 charity’s charitable purposes
  - b) the charity ensures disbursement exclusively applied to charitable activities in furtherance of its charitable purposes
  - c) The charity maintains documentation sufficient to demonstrate (a) and (b)
- Therefore, DAF Holding Charities that only have a charitable purpose to making gifts to qualified donees cannot make gifts to grantee organizations
- Addition of a new charitable purpose(s) may be required – this takes time, charitable resources and requires regulator approval

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## Current Issues Associated with DAFs

### 5. Qualifying Disbursements – Directed Giving Provision

- Paragraph 168(1)(f) of the ITA was amended in June 2022 and now 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
- However, it is not clear what is considered to be “implicitly conditional”
- For example, could a donation to a DAF followed by a request from the donor that a gift be made to a local non-profit organization as a qualifying disbursement trigger this provision?
- Further clarity is needed, both in the legislation itself and in CRA guidance(s)

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## Current Issues Associated with DAFs

### 6. Importance of Granting Policies

- Important 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
- DAF Holding Charities may place their own limitations on the type of qualified donees that are able to receive gifts from their DAFs, *e.g.* geographic, religious, cultural/philosophical or program-based
  - Make these restrictions clear to donors in granting policy or guidelines, which should then be cross-referenced in agreement establishing the DAF
- But not enough to have such a granting policy, there also needs to be ongoing monitoring and enforcement by the DAF Holding Charity

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## Current Issues Associated with DAFs

### 7. Impact of Alternative Minimum Tax

- Budget 2023 proposed to make changes to the federal alternative minimum tax (“AMT”) (a tax which applies if it is higher than the tax an individual would pay under “regular” tax rules)
- A proposed change is that 30% of the capital gains on donations of publicly listed securities would be included in the calculation of the AMT (currently these capital gains would not be included)
- If this change is adopted into legislation, it could impact high net-worth donor’s giving patterns, including the gifts made to DAFs

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## Current Issues Associated with DAFs

### 8. Successors / Heirs of DAFs

- As exemplified in the case of *The Joseph Lebovic Charitable Foundation v Jewish Foundation*, a DAF Holding Charity may continue to receive recommendations about distributions from the DAF from a donor's family member or other successor
- DAF Holding Charity will need to consider what to do if donor does not designate a successor or if multiple successors give contrary recommendations
- Thought should also be given to successors for DAF donors that are not individuals, e.g. corporations or a group of unrelated people

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## Current Issues Associated with DAFs

### 9. Impact of "Anonymous" Donations from DAFs to Charities

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)

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## Current Issues Associated with DAFs

### 10. Uncertain Application 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 narrow the situations in which an entity is exempt from filing a T3 trust return
- While CRA's long-standing administrative policy is not to require charities to file T3s for their internal (express) trusts, it is unclear what information it may now expect charities to file re: assets held internally in trust

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## How to Work with DAFs?

### 1. Properly Establishing and Managing DAFs

- DAF Holding Charity must:

Maintain ownership of the DAFs and their assets

Retain control over all decisions

Take all necessary steps to appropriately advise donors, initially and on an ongoing basis, about the advisory nature of donor input

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## How to Work with DAFs?

- Documents creating a DAF must clearly state that (1) the DAF Holding Charity administers the fund and (2) the DAF Holding Charity reserves the right to not follow a donor's advice
- The gift agreement establishing a DAF could also address:
  1. Name of the DAF
  2. Minimum initial amount required to establish DAF
  3. Length of time donor has to reach minimum amount (and what happens if they don't)
  4. Fees charged in relation to administration of DAF and its investments
  5. How often gifts to QDs are made from DAF and any minimum gift amounts

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## How to Work with DAFs?

6. General parameters for types of QDs or grantee organizations that will receive gifts from the DAF
  7. Manner and frequency of soliciting donor's advice
  8. If / How donor may appoint a successor advisor for the DAF
  9. Any special investment powers DAF Holding Charity has in relation to the DAF assets
  10. A requirement that the donor's advice (but not approval) is sought if the DAF Holding Charity decides to transfer the DAF to another charity under the *Trustee Act* (Ontario)
- Gift agreements should originate from the DAF Holding Charity, be thoroughly reviewed with the donor (who should obtain independent legal and tax advice), and signed by both parties

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## How to Work with DAFs?

- DAF Holding Charity must properly manage the DAF:

1. Comply with all donor restrictions, as well as any donor advice requirements in gift agreement
2. Track and manage each DAF separately from other DAFs / restricted funds
3. Invest assets in DAF in accordance with investment powers in gift agreement / general investment powers of charity
4. Not comingle DAF and other restricted funds with a charity's general funds or internally restricted funds for investment purposes

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## How to Work with DAFs?

5. Report gifts made from a DAF to a QD on DAF Holding Charity's annual T3010
6. Maintain all non-public personal donor information in strict confidentiality and security
7. Consistently observe donor restrictions imposed on DAF at time gift establishing the DAF was made
8. Ensure any transfer of a DAF to another charity is done with written appointment pursuant to s. 3 of the *Trustee Act* (Ontario)

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## How to Work with DAFs?

### 2. Practical Advice for Advising Clients

- Do your homework
    - Take the time to do appropriate due diligence at the start so that you can advise a charity on how to manage / administer DAFs correctly in accordance with legal obligations
  - Create templates
    - Develop and implement written gift acceptance policies addressing DAFs and other gifting vehicles
    - Prepare appropriate DAF gift agreements
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## How to Work with DAFs?

- Ensure the DAF Holding Charity runs the process
    - The DAF Holding Charity – not the donor or donor’s legal counsel – should be in control in establishing DAFs, utilizing consistent procedures as set out in policy and gift agreements
  - Be Vigilant
    - Advise DAF Holding Charities to avoid language that refers to DAFs as belonging to the donor, suggestions that donors are “clients” with “accounts” and that a DAF is a donor’s own private foundation
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## How to Work with DAFs?

- Identify Opportunities
  - DAFs represent opportunities for ongoing engagement with donors
  - Could DAFs be a new way for a client to attract larger gifts from donors?
  - Consider how the ability to provide ongoing advice might encourage donors to make larger gifts to a DAF Holding Charity that are then directed to that charity's activities over the subsequent years

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## Conclusion

- DAFs that are properly set up and operated correctly can facilitate gifts for the charitable sector
- However, both charities and donors should clearly understand the legal requirements of DAFs before involvement with them
- If legal requirements for DAFs are not complied with, there is a possibility that the gifts made will be invalidated (and therefore preclude or invalidate any charitable donation receipts)
- DAFs will likely continue to grow in Canada, therefore it is important that those involved with DAFs understand their context and legal underpinnings, as well as the impact of recent (and possible future) changes to the ITA on DAFs

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# QUESTIONS



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