

# PRIMER ON DONOR ADVISED FUNDS AND CURRENT ISSUES – REVISITED

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## A. INTRODUCTION

The topic of donor advised funds (“DAFs”) has generated a considerable amount of attention in the past decade or so, receiving both praise as well as criticism. While some of this criticism may warrant further review and consideration, many of the concerns regarding DAFs, particularly here in Canada, are either unfounded or exaggerated.

In 2019, the author wrote a primer on DAFs and current issues, which outlined the context of DAFs, current issues then associated with these funds, and practical advice for those advising clients about DAFs.<sup>1</sup> Four years later, given the ongoing and accelerating interests in DAFs, it is important to revisit the topic of DAFs.

While much has changed with DAFs since 2019, some aspects of DAFs remain the same. In order to be legally valid, DAFs must be properly established, held, maintained, and then utilized on an ongoing basis by recipient charities in compliance with both trust and tax law. Failure to do so could result in a DAF (and gifts made to the DAF) being determined to be invalid. This, in turn, could potentially erode donor confidence, expose the recipient charity of the DAF to potential liability, and undermine the recipient

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<sup>1</sup> Jacqueline M. Demczur, “Primer on Donor Advised Funds and Current Issues” *CBA Charity Law Symposium 2019* (6 May 2019), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/seminar/charity/2019/Paper-Primer-or-Donor-Advised-Funds-and-Current-Issues-Jacqueline-Demczur-2019-05-06.pdf>> [“2019 Primer”].

charity's credibility as well as that of the larger charitable sector. Therefore, it remains important that the charitable sector and their advisors remain informed about the law as it applies to DAFs and the expectations of the public, so as to avoid any serious compliance or reputational risks.

This paper will provide an overview of the context of DAFs in Canada and how it has continued to develop; review the key legal aspects of establishing and functionally operating DAFs; provide an overview of both the current and new emerging issues associated with these funds; as well as equip the reader with some practical advice when advising clients in relation to DAFs.

## B. CONTEXT OF DAFS

### 1. What is a DAF Anyway?

In broad terms, a DAF is a type of charitable giving vehicle that is established when a fund is created by a donor through an initial donation of capital to a registered charity in accordance with the *Income Tax Act* (Canada) (“ITA”).<sup>2</sup> The registered charity in question is usually a charitable foundation<sup>3</sup> (either a public foundation or a private foundation), although DAFs can also be established with a charitable organization<sup>4</sup> (hereinafter a recipient registered charity of a DAF will be referred to as a “DAF Holding Charity”).

The gift (and any subsequent gifts) by the donor to the DAF held by the DAF Holding Charity is irrevocable, and the donor receives a charitable donation receipt from the DAF Holding Charity in exchange for each gift. Donations to DAFs within a DAF Holding Charity can be cash, securities or other investments, insurance proceeds, or bequests. Amounts from any DAF, which could include capital (if the DAF is not perpetually endowed, such as an expendable DAF) and income generated by the capital, are then gifted, either outright or over a period of time, by the DAF Holding Charity over to qualified donees,<sup>5</sup>

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<sup>2</sup> *Income Tax Act* (Canada), RSC, 1985, c 1 (5th Supp) [“ITA”]. There are three types of registered charities under the *Income Tax Act* (Canada), namely charitable organizations, public foundations and private foundations. The designation of a charity depends primarily on its structure, its source of funding and the mode of operation. For more information, see “Types of registered charities (designations)” online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/registering-charitable-qualified-donee-status/apply-become-registered-charity/establishing/types-registered-charities-designations.html>>.

<sup>3</sup> See ITA, *ibid*, s 149.1(1) definition of “charitable foundation”.

<sup>4</sup> See ITA, *ibid*, s 149.1(1) definition of “charitable organization”.

<sup>5</sup> See ITA, *ibid*, s 149.1(1) definition of “qualified donee”. See also “Qualified Donees” CG-010 (15 August 2011), online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/qualified-donees.html>> [“CG-010”].

with most gifts usually being made to registered charities. However, with amendments made to the ITA in 2022, it is now possible for amounts from a DAF to also be given by a DAF Holding Charity to non-qualified donees referred to as “grantee organizations” (as will be discussed in greater detail later in this paper).<sup>6</sup>

In a DAF, the donor is given the unique role of being able to periodically make non-binding recommendations to the DAF Holding Charity concerning the distribution of assets from the DAF over to other registered charities. This consultation process between the DAF Holding Charity and the donor usually takes place annually, although it can be more frequently. However, despite the donor’s ability to provide advice, all administrative, operational, and governance matters of a DAF, including compliance with the ITA and policies of the Canada Revenue Agency, Charities Directorate (“CRA”), are the sole responsibility of the DAF Holding Charity.<sup>7</sup> This is because the DAFs are the property of the DAF Holding Charity alone, not the donor.

Although DAF Holding Charities have fully vested ownership of the DAFs, they will generally follow the advice received from the DAF’s donor advisors. This relationship of trust between the donor advisor and the DAF Holding Charity is a key feature of this particular charitable giving vehicle. However, it is very important that all parties involved in DAFs completely understand how DAFs work, both legally and functionally, at the outset so that there are no unexpected problems or challenges in the future.

## 2. History, Development and Current Size of DAFs

Community foundations have played an instrumental role in the development of DAFs over the years. For example, the first DAF in the United States was established by the New York Community Trust for

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<sup>6</sup> See ITA, *ibid*, s 149.1(1) definition of “grantee organization”.

<sup>7</sup> See Arthur BC Drache, “When Donor Advice is Not Taken” (24 February 2017), online: *Drache Aptowitz LLP* <<https://drache.ca/articles/when-donor-advice-is-not-taken/>>. This article, citing a Non-Profit Quarterly article, describes two separate situations where DAF holding foundations refused to honor the donor’s advice on charities to receive gifts because of the applicable foundation board’s political views. The Non-Profit Quarterly article noted that the donors in question were considering moving their DAFs as a result, but it is important to note, at least in Canada, that this is not possible at law. While the charity holding the DAF can undertake a change of trustee for a particular DAF to another registered charity, presumably at the donor’s request, the decision to do so is that of the charity alone, not the donor.

William Barstow in 1931.<sup>8</sup> In Canada, the first DAF was established in the Vancouver Foundation in 1952 by Whitford J. Van Duisen, one of the Foundation's founders and its first chairman.<sup>9</sup>

A significant event in the development of DAFs was the establishment of the Fidelity Charitable Gift Fund in 1991 by US-based Fidelity Investments. This was the start of financial services firms becoming involved in DAFs, which had up to then been largely the domain of community foundations. The growth of DAFs since then has been significant, particularly in the United States.<sup>10</sup>

By comparison, it was not until 2004 that financial services firms in Canada started establishing affiliated foundations focused on holding DAFs, with the first one being the Private Giving Foundation by the Toronto Dominion Bank.<sup>11</sup> Thereafter, the growth of DAFs in Canada accelerated following the 2006 and 2007 ITA amendments and as a result of the changing demographics of wealth.<sup>12</sup> Specifically, the 2006 ITA amendments eliminated capital gains tax on donations of publicly-traded securities to charitable organizations and public foundations made after May 1, 2006.<sup>13</sup> The ITA was further amended in 2007 to permit private foundations to also receive these types of donations, effective as of March 19, 2007.<sup>14</sup> As a result of these changes, individuals holding publicly-traded securities were incentivized to make gifts to the charitable sector in order to benefit society, as well as receive considerable tax benefits in exchange.

These ITA changes led, among other things, to the establishment in Canada of a number of public and private foundations whose sole purpose is to hold DAFs.<sup>15</sup> As evidenced in the chart below, both the number of DAFs held and the overall distribution of DAF assets are highest in community foundations,

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<sup>8</sup> Joanna Florino, "Gifting Made Easy" (June 2015), online: *Philanthropy Roundtable*

<<https://www.philanthropyroundtable.org/philanthropy-magazine/article/spring-2015-giving-made-easy>>.

<sup>9</sup> Devon Hurvid, "Donor Advised Funds: What Fundraisers Should Know" (24 April 2019) online: *Imagine Canada* <<https://www.imaginecanada.ca/en/360/donor-advised-funds-what-fundraisers-should-know>> ["Hurvid"].

<sup>10</sup> For further information about the growth of DAFs in the United States, please see 2019 Primer, *supra* note 1 at 4-5.

<sup>11</sup> Keith Sjogren, "Donor-Advised Funds Attracting Attention" (12 June 2018), online: *Strategic Insight* <<https://www.strategic-i.com/blog/donor-advised-funds-attracting-attention/>>.

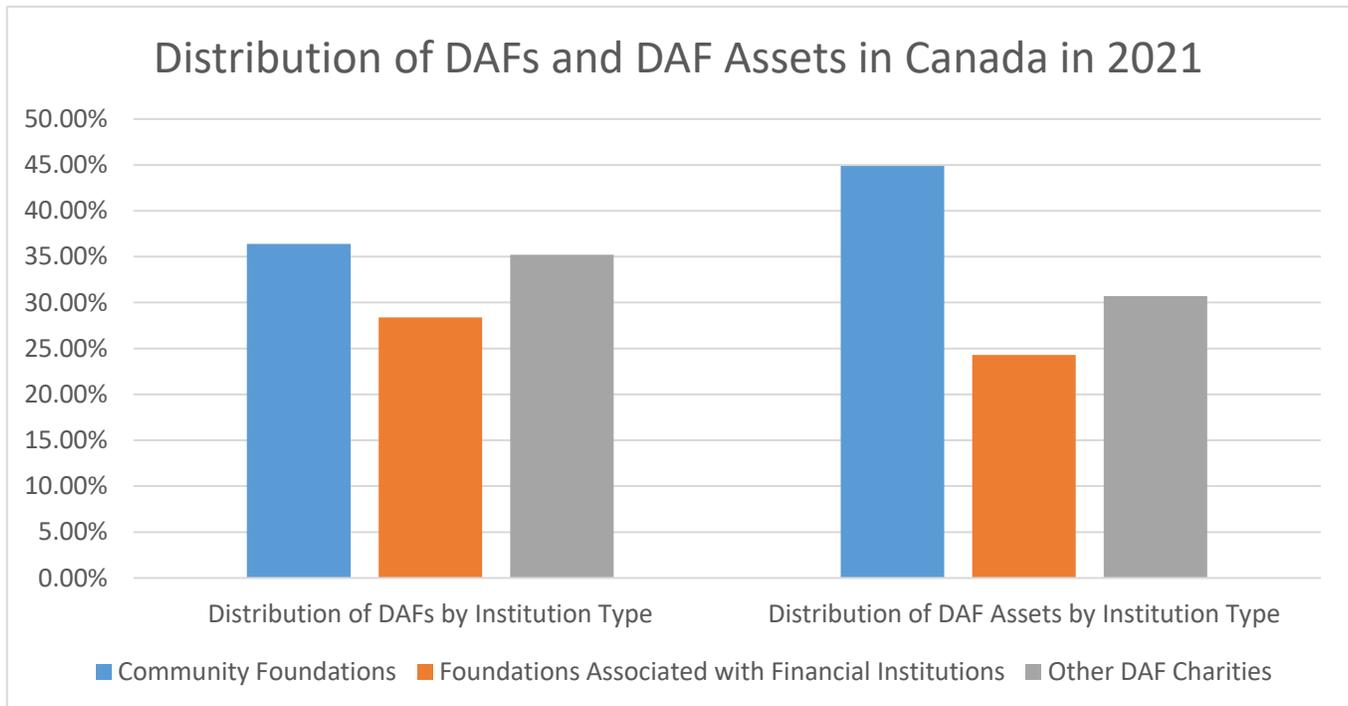
<sup>12</sup> See remarks by Keith Sjogren, Managing Director, Strategic Insight, to the Special Senate Committee on the Charitable Sector (18 September 2018), online: *Senate of Canada* <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/06ev-54210-e>> ["Sjogren 2018"].

<sup>13</sup> Karen J Cooper and Terrance S Carter, "Budget 2006: Elimination of Capital Gains Tax on Certain Gifts" *Charity Law Bulletin No. 113*, (30 May 2006), online: *Carters Professional Corporation* <<http://www.carters.ca/pub/bulletin/charity/2006/chylb94.htm>>.

<sup>14</sup> Karen J Cooper and Terrance S Carter, "Federal Budget 2007: Highlights for Charities" *Charity Law Bulletin No. 113* (29 March 2007), online: *Carters Professional Corporation* <<http://www.carters.ca/pub/bulletin/charity/2007/chylb113.pdf>>.

<sup>15</sup> See Sjogren 2018, *supra* note 12.

but they are far from being the only players in this space.<sup>16</sup> Foundations associated with financial institutions have a healthy DAF market share, as do charities that are neither community foundations nor associated with a financial institution, *e.g.* those which are either independent or faith-based (referred to in this paper as “Other DAF Charities”). Both of these other categories hold nearly as many of the offered DAFs as those held by community foundations.



In terms of the future, DAFs are expected to continue to grow in popularity in Canada. The reasons cited for this include the anticipated creation and ownership of wealth in Canada, the projected ongoing significant transfer of wealth in the next 20 years, and the growing popularity of “retail philanthropy” by foundations affiliated with financial institutions as well as community foundations. From 2019 to 2021,

<sup>16</sup> “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 11-14 [“CAGP Paper”]. The chart set out on this page has been created by the author utilizing the data set out on pages 11 (figure 2) and 13 (figure 13) of the CAGP Paper.

Please note that one of the organizations classified as “Other DAF Charities”, namely, Charitable Gift Funds Canada, recently entered into an arrangement with RBC and, therefore, in the future, these amounts may be considered to be part of the “Foundations Associated with Financial Institutions” category. In addition, it should be noted that these numbers do not include numbers reported by Charitable Impact, a standalone foundation that has a unique operating model which generally permits individuals to open DAF funds with very limited capital. This has resulted in Charitable Impact holding over 100,000 DAFs and, as the CAGP Paper notes, this data could “skew the output”.

DAF assets increased by \$3.1 billion, for a total of \$8.5 billion being held in DAFs at the end of 2021.<sup>17</sup> It is projected that DAF assets will reach \$12.5 billion by the end of 2025.<sup>18</sup>

### 3. Who are the Key “Players” in DAFs?

Each of the following groups have a key role in the operation of DAFs in Canada:

#### a) Donors

The starting point is the donors, who can gift various types of assets to initially establish their DAFs and then fund them on an ongoing basis. It is generally thought that the growing attraction of DAFs to donors is their desire for ongoing control, or at least input, over the application of the assets held in the DAF for charitable purposes. Whether donors attain this level of control or not, legally or functionally, will be reviewed later in this paper.

#### b) DAF Holding Charities

DAFs are able to be established and held by a variety of registered charities, including community foundations, foundations established by or associated with financial institutions, charities specifically established to hold DAFs, as well as more traditional charities, including religious denominations, post-secondary educational institutions, national organizations, parallel foundations and the like.

#### c) Community Foundations

Generally speaking, but subject to their specific charitable purposes, community foundations focus on raising monies from donors in a particular geographical area, e.g. a city or a region/county, and then expending those monies for local causes and registered charities located in the same community. As shown above, community foundations are currently the biggest holders of DAFs in Canada.

#### d) Foundations established by or associated with financial institutions

Over the past few years, many financial institutions and wealth management firms have either established their own “captive” in-house charitable foundations<sup>19</sup> or entered into partnerships with independent

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<sup>17</sup> CAGP Paper, *ibid* at 12.

<sup>18</sup> CAGP Paper, *ibid* at 38.

<sup>19</sup> In Canada, these financial institutions include large banks (e.g. TD Bank and the Bank of Nova Scotia), credit unions (e.g. Vancouver City Savings Credit Union) as well as mutual funds and financial services firms (e.g. MacKenzie Investments, Investors Group, Nicola Wealth Management, and Raymond James Canada).

foundations<sup>20</sup> in order to enable their financial advisors to offer DAFs and related advisory services to their own clients.<sup>21</sup>

As part of holding and administering their DAFs, these foundations utilize the investment services of their related financial institutions to invest the capital amounts within the DAFs. This generally results in the management and investment fees associated with these services remaining within the financial institution “family”.<sup>22</sup>

e) Other DAF Charities

There is a broad variety of Other DAF Charities, including independent registered charities established for the sole purpose of offering DAFs or raising monies from the community to then gift over to other registered charities as well as single-issue focused charities established to receive and hold DAFs for the benefit of their particular sector (e.g. various religious organizations, higher education institutions, hospitals, etc.). As explained above, they often establish partnerships with financial services firms to obtain required investment services.

f) Qualified Donees and Grantee Organizations Receiving Gifts from DAFs

The gifts to be made from the income and/or capital of a DAF, as applicable, are given to qualified donees<sup>23</sup> or, as a result of recent amendments, grantee organizations in accordance with the ITA. Usually on an annual basis, the DAF Holding Charity will consult with each DAF’s original donor(s) (and/or possibly “fund advisors” appointed by the donor) to request their advice on the recipient qualified donees, which are usually registered charities, to receive gifts from the DAF in the applicable year. A DAF Holding Charity may also be able to give grants to grantee organizations (an organization that is not a qualified donee),<sup>24</sup> subject to its then existing charitable purposes and if such grants would meet the requirements of the ITA as qualifying disbursements (addressed in greater detail in Section D.2 of this

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<sup>20</sup> Examples of these include BenefAction Foundation (working with CIBC Private Wealth Management and Assante Management), Charitable Gift Funds Canada Foundation (working with RBC Dominion Securities and the Bank of Montreal) and Aqueduct Foundation (working with Scotiabank).

<sup>21</sup> See CAGP Paper, *supra* note 16 at 9.

<sup>22</sup> James Andreoni, “The Benefits and Costs of Donor Advised Funds” (paper presented at the Tax Policy and the Economy Conference, Washington, DC, 29 October 2017), online: <<https://inequality.stanford.edu/sites/default/files/Andreoni-paper.pdf>> .

<sup>23</sup> See CG-010, *supra* note 5. Under the ITA, qualified donees are organizations that can issue official donation receipts for gifts that they receive from individuals and corporation. They can also receive gifts from registered charities but do not need to issue a donation receipt in exchange for the gift.

<sup>24</sup> ITA, *supra* note 2 at s 149.1(1) “**grantee organization** includes a person, club, society, association or organization or prescribed entity, but does not include a qualified donee”.

paper).<sup>25</sup> However, the final decisions on the approved gift recipients are those of the DAF Holding Charity itself as the owner of the DAFs, not the donor.

g) The CRA

All DAF Holding Charities will invariably be registered charities so that official donation tax receipts can be issued to donors in accordance with the ITA. Whether other types of qualified donees could act as DAF Holding Charities is beyond the scope of this paper but there would not appear to be any reason why a qualified donee that can receive and administer a restricted purpose charitable trust would also not be able to hold and administer a DAF.

As indicated earlier in this paper, DAF Holding Charities are usually either public foundations or private foundations. As registered charities, DAF Holding Charities are regulated by the CRA and must be in compliance with all of the applicable requirements of the ITA, as well as all applicable CRA policies for registered charities.

h) Others, *e.g.* Financial Advisors

One key factor in the growth of DAFs within the financial sector is the role of financial advisors in advising their clients on the philanthropy options available to them, including the establishment and use of DAFs. Individuals who are interested in establishing DAFs will often consult their financial advisors on how and with which charitable foundation to do so. Where this occurs, the financial advisor may receive a bonus from the DAF Holding Charity for the initial client referral, as well as potential future bonuses depending on the ongoing value of the assets held in the DAF.<sup>26</sup> By contrast, where a financial advisor's client establishes a DAF with a non-financial services related DAF Holding Charity, such as a community foundation, then there is presumably less ability for the financial advisor to receive such bonuses.

4. Why are DAFs so popular now?

A growing trend for at least the last 20 years has been donors' desire for more "control" over their charitable donations.<sup>27</sup> In this regard, DAFs established in DAF Holding Charities are often described as

<sup>25</sup> See the ITA requirements in *ibid*, s 149.1(1) definition of "qualifying disbursement" at (b).

<sup>26</sup> Chuck Collings, Helen Flannery & Josh Hoxie, "Warehousing Wealth: Donor-Advised Charity Funds Sequestering Billions in the Face of Growing Inequality" (July 2018), online: *Institute for Policy Studies* <<https://ips-dc.org/wp-content/uploads/2018/07/Warehousing-Wealth-IPS-Report-1.pdf>> at 30-31.

<sup>27</sup> Charlotte Cloutier, "Donor-Advised Funds in the U.S.: Controversy and Debate" (1 September 2004) 19:2 *The Philanthropist*, online: <<https://thephilanthropist.ca/2004/09/donor-advised-funds-in-the-u-s-controversy-and-debate/>>.

a practical and appealing alternative for donors who do not have the ability, interest, time or, frankly, the wealth to set up and operate their own private family foundations, being the traditional vehicle by which families with considerable wealth conducted their philanthropy over successive generations.<sup>28</sup>

By establishing a DAF within a DAF Holding Charity, the donor avoids the burdensome task of establishing and then operating their own private foundation but retains the ability to provide ongoing input into how their charitable donations are distributed to the charitable sector over the short and sometimes the long term. This is accomplished by providing each DAF donor with an ongoing advisory role in relation to the DAF, while all administrative, operational and governance matters are handled by the DAF Holding Charity.<sup>29</sup> Functionally though, there is the perception, rightly or wrongly, that donors actually have *de facto* control over the utilization of the assets held in their DAFs for charitable purposes. This issue of what a DAF can be, both legally and functionally, will be reviewed in more detail later in this paper.

It is also relatively inexpensive for donors to establish a DAF as compared to setting up and then operating a private family foundation, which requires a significantly larger capital amount. This means that DAFs can be utilized by a greater number of potential donors with considerably less personal wealth than those who have private foundations. Generally speaking, any donor can establish a DAF with a DAF Holding Charity by gifting a minimum initial donation amount. While this minimum initial donation amount can vary from charity to charity, it can be as low as \$5,000 and, in some cases, there may not be any minimum amount at all.<sup>30</sup> By way of contrast, unless they are established to facilitate flow through donations to qualified donees, private foundations are generally established with at least a \$1 to \$2 million capital asset base.

Another possible reason for the popularity of DAFs is the seeming anonymity that they provide to their donors, though it has been reported that anonymity is not generally viewed by donors as an important

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<sup>28</sup> M. Elena Hoffstein, “Private Foundations and Community Foundations” (paper delivered at the Canadian Tax Foundation Fifty-Ninth Annual Tax Conference, 25-27 November 2007), online: <<https://www.carters.ca/pub/article/charity/2007/meh1125.pdf>>. In this paper, the author compares and contrasts private foundations and community foundations and, among other issues, reviews whether community foundations holding DAFs can “approximate the benefits of a private foundation” (at 29).

<sup>29</sup> Hurvid, *supra* note 9.

<sup>30</sup> CAGP Paper, *supra* note 16 at 40.

factor in choosing to use a DAF.<sup>31</sup> Since it is the DAF Holding Charity that makes the gifts, not the donor directly, recipient charities are not always advised of the DAF donor's identity. This then shields the DAF donor from receiving ongoing solicitations for new donations from these recipient charities, which is regularly what takes place after a donor makes a direct gift to a registered charity.<sup>32</sup>

### C. WHAT IS A DAF AT LAW?

In general terms, a DAF is a common type of restricted charitable purpose trust, which is also known as a donor restricted charitable gift. If a charity accepts a gift subject to a restricted charitable purpose trust, then it is legally bound to comply with those restrictions and fully understand the implications of not doing so. Recipient charities must fully understand the various "layers" associated with donor restricted charitable gifts, including their basic attributes, the impact of imposed donor restrictions, as well as applicable tax law. This section provides a brief discussion of these legal components of a DAF.

#### 1. What is a Charitable Gift?

The first question to be examined is what constitutes a gift? Under the common law, the Federal Court of Appeal has defined a gift as a "voluntary transfer of property owned by the donor to a donee, in return for which no benefit of consideration flows to the donor."<sup>33</sup> There are two main types of gifts under the common law: *donatio mortis causa* (gifts made in prospect of death) and gifts *inter vivos* (gifts made during one's lifetime).<sup>34</sup> This paper focuses on *inter vivos* gifts.

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<sup>31</sup> Carla Funk, "Donor-advised funds and charitable foundations in Canada" in Peter R Elson, Sylvain A Lefèvre & Jean-Marc Fontan, eds, *Philanthropic Foundations in Canada: Landscapes, Indigenous Perspectives and Pathways to Change*, (PhiLab, 2020) at 7. See also CAGP paper, *supra* note 16 at 34 ["Funk"].

<sup>32</sup> Keith Sjogren & Carol Bezaire, "Help Canadians Give: Donor-Advised Funds as a Philanthropic Strategy" (28 March 2018), online: *MacKenzie Investments* <<https://www.mackenzieinvestments.com/en/products/charitable-giving-program/help-canadians-give>> at 6.

<sup>33</sup> *Friedberg v R.* (1991) 92 DTC 6031 (Fed CA), affirmed [1993] 4 SCR 285 ["Friedberg"].

<sup>34</sup> Department of Justice, "The Concept of a Gift/Don Comparative Study – Civil Law Common Law Tax Law", online: Government of Canada <<https://www.justice.gc.ca/eng/rp-pr/csj-sjc/harmonization/siroi/gift3-don.html>> [Concept of a Gift/Don]. See particularly n 62. For further information, see also Kathryn Chan, "The Perils of Federalizing the Common Law: A Case Study of the ITA Gift Concept" (2017) 50 UBCL Rev 579 at 585 ["Chan"].

There are three conditions, under the common law, which must be met for an *inter vivos* gift to be valid: 1) the gift must be voluntary,<sup>35</sup> 2) there must be a transfer of property,<sup>36</sup> and 3) the donor cannot receive any consideration for making the gift.<sup>37</sup>

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

The next question to review is whether a charitable gift is unrestricted or restricted? An unrestricted charitable gift is a gift at law to be applied towards a charitable purpose, but which is not subject to any direct or indirect restrictions imposed by the donor other than the requirement that the gift be used for the recipient charity's charitable purpose(s).<sup>38</sup> This means that, provided the gift is used within the parameters of the applicable charitable purposes, the recipient charity is able to use the gift at its absolute discretion.

By contrast, a donor restricted charitable gift is generally described as “a gift at law to a charitable purpose that is subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would constrain or limit a charity concerning how the gift can be used”.<sup>39</sup>

When a charity receives a donor-restricted charitable gift, then its board of directors must be careful to identify the nature of the donor restriction(s), recognize the legal consequences and practical implications of the specific type of donor restriction(s) being imposed, as well as the importance of ensuring compliance with them at all times. This is because a charity's directors or trustees must carry out its charitable purposes in accordance with the restrictions imposed by donor restricted charitable gifts.<sup>40</sup>

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<sup>35</sup> The donor must have a clear intent to make a gift and must have the requisite capacity at law to make the gift (i.e. the donor is not acting under duress or is mentally incompetent); the gift must be real or personal property; and the donor cannot be under any legal obligation or coercion to make the gift, or it will be invalid.

<sup>36</sup> The property to be gifted must actually be transferred or delivered to the intended recipient by the donor, with evidence of the said delivery or transfer and subsequent acceptance by the donee. Generally speaking, this acceptance of a gift by the donee or recipient charity is presumed upon the delivery of the property that is the subject matter of the gift by the donor to the donee. Concept of a Gift/Don, *supra* note 34. For further information, see also Chan, *supra* note 34 at 585.

<sup>37</sup> It is important to ensure that the donor does not retain control or possession of the gift once it is given to the intended recipient. Excessive on-going control by the donor over the gifted property may defeat or negate the gift. See *Friedberg*, *supra* note 33. See also *Mariano v R*, 2015 TCC 244 at 17.

<sup>38</sup> Terrance S. Carter, “Donor-Restricted Charitable Gifts: A Practical Overview Revisited II” (Paper presented for the Canadian Association of Gift Planners at the 2006 Annual National Conference, 2006), online: *Carters Professional Corporation* <<http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>> at 9 [“Carter 2006”].

<sup>39</sup> *Ibid* at 11.

<sup>40</sup> *Tudor on Charities*, 8th ed., Jean Warburton and Deborah Morris (London: Sweet and Maxwell, 1995) at 191.

Failure by a charity to identify, understand, and comply with donor restrictions on gifts will potentially expose it and its board to potential breach of trust allegations.<sup>41</sup>

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

Donors who intend to receive tax benefits under the ITA for their donations need to ensure that those donations are gifts both at common law and under the ITA. While the CRA has adopted the traditional common law definition of a gift, being "a voluntary transfer of property owned by a donor to a donee, which the donee makes without anticipation, expectation or receipt of material benefit",<sup>42</sup> it is important to be aware that gifts for income tax purposes are not necessarily the same as gifts at common law.

The ITA's definition of property includes property of any kind whatsoever, whether real or personal, and can include cash, real estate, securities, tangible assets such as equipment, etc., but a gift of property does not include services, the use of a timeshare, or a pledge of property which has not yet been fulfilled.<sup>43</sup> Further, unlike the common law definition of gift which precludes a donor from receiving any consideration from a gift, the split receipting rules under the ITA permit donors to receive an advantage (i.e. consideration or a benefit) in exchange for having made a gift to a recipient charity.<sup>44</sup>

Charities should be aware which donations are properly gifts under the ITA and can be receipted, so as not to be offside of receipting rules.<sup>45</sup> Also, it is very difficult and sometimes impossible to return a donation of an improper gift, because at law, a gift transfers ownership of the gifted property from the donor to the charity. Once the transfer is made, the gifted property belongs to the charity and it is obliged

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<sup>41</sup> See Carter 2006, *supra* note 38 at 52-54 for examples of situations where the courts have found that a breach of trust by directors or trustees has occurred for failing to follow the terms of a donor-restricted charitable gift.

<sup>42</sup> Chan, *supra* note 34 at 579-580. See also Concept of a Gift/Don, *supra* note 34 and "Gifts and Income Tax – 2022" CRA Guide P-113, online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p113/p113-gifts-income-tax.html>> [P-113].

<sup>43</sup> "What is a gift?" online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/receiving-gifts/what-a-gift.html>> ["What is a gift?"]. See also the definition of "property" in the "Charities and Giving Glossary", online: *Government of Canada* <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/charities-giving-glossary.html#prprty>.

<sup>44</sup> P-113, *supra* note 42.

<sup>45</sup> Penalties for improper receipts may lead to CRA sanctions, penalties or even revocation of registered charitable status. "Consequences of Improper Receipting", online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/issuing-receipts/consequences-improper-receipting.html>>. See also "Penalties and Sanctions", online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/penalties-suspensions.html>>. For more information, please see 2019 Primer, *supra* note 1.

to use the gift in carrying out its charitable purposes.<sup>46</sup> Given that a charity's ability to return donated property back to a donor is very complicated and can only be done if there was a legal basis to do (such as lack of capacity or mistake), the return of a gift should be avoided if at all possible.<sup>47</sup>

#### 4. How Does This All Relate to a DAF?

A DAF is a distinct fund within the structure of a DAF Holding Charity which is established when a donor (and possibly others, such as family and friends) makes a single gift or, if they wish, a series of irrevocable gifts to the said DAF Holding Charity. This gift must have all of the features of a gift explained in the earlier sections of this paper. However, the unique aspect of a DAF is that, in addition to any specific donor restrictions that may (or may not) be impressed upon the gift at its inception, there is, at a minimum, a donor-advised "feature" added to the gift by the donor, providing them with ability to be able to offer ongoing advice to the DAF Holding Charity on one or more specified aspects of the DAF.<sup>48</sup>

While these donor suggestions do not actually impose a legal obligation upon the DAF Holding Charity to accept any of these suggestions, they do result in a moral obligation for the DAF Holding Charity to consider the donor advice received and presumably generally follow such advice. However, at all times, the ultimate decision about which qualified donee should receive gifts from the DAF should be made by the DAF Holding Charity itself.

Recently, the Ontario Superior Court of Justice has confirmed that while donors are free to make recommendations to a DAF Holding Charity on how monies in their DAF are to be granted, the DAF Holding Charity is under no obligation to follow these recommendations. In the case of *The Joseph Lebovic Charitable Foundation v. Jewish Foundation*,<sup>49</sup> a donor had established a DAF with the Jewish Foundation of Greater Toronto ("JFGT") and subsequently made recommendations as to how funds were

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<sup>46</sup> "Returning a Gift to a Donor" online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/receiving-gifts/returning-a-gift-a-donor.html>>.

<sup>47</sup> In this situation, the charity must file an information return with the CRA within 90 days after the day the property is returned, as well as provide the donor with a copy of the said information return. See *ibid*. See also "Qualified donees – Consequences of returning donated property" CRA Guidance CG-016, (19 October 2012), online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-016-qualified-donees-consequences-returning-donated-property.html>>.

<sup>48</sup> Terrance S Carter, "Considerations in Drafting Restricted Charitable Purpose Trusts" (Paper delivered at The Society of Trust and Estate Practitioners Canada STEP Canada 19th National Conference, 12 June 2017), at 4, online: <<http://www.carters.ca/pub/article/charity/2017/STEP-Drafting-Restricted-Charitable-Purpose-Trusts.pdf>> ["Carter 2017"].

<sup>49</sup> *The Joseph Lebovic Charitable Foundation v. Jewish Foundation*, 2022 ONSC 4012 ["*Joseph Lebovic*"].

to be spent. After the donor passed, his brother assumed control of the DAF as the executor of the donor's estate. The brother brought a motion to prevent the JFGT from spending a small portion of the funds from the DAF contrary to his requests. After consideration of the facts in this case, the court found that the brother lacked grounds for this motion and confirmed 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.<sup>50</sup>

Since the DAF Holding Charity must retain and exercise control over all decisions associated with the DAF, including investing and gift distribution, it must appropriately advise its donors that their input in relation to the DAF can be of an advisory nature only. This is important to ensure that the donations being made by the donor to the DAF are true gifts at law and are able to be properly receipted as such under the ITA.<sup>51</sup> Where there is excessive on-going control by the donor over the gifted property, the CRA may consider the gift to be defeated or negated,<sup>52</sup> which means that it cannot be receipted under the ITA.

#### D. CURRENT ISSUES ASSOCIATED WITH DAFS

While it is certainly not an exhaustive list of all possible DAF-related concerns or how they might be best addressed and/or resolved, the purpose of this section is to raise awareness of some key issues with DAFs currently being considered in the Canadian charitable sector.

##### 1. Disbursement-Related Issues

A perennial issue associated with DAFs is whether there are sufficient distributions being made from individual DAFs to the larger charitable sector. Concerns about the distributions from DAFs by DAF Holding Charities have been particularly elevated following the 2019 Report of the Special Senate Committee on the Charitable Sector ("Senate Committee Report") in which the Senate Committee

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<sup>50</sup> For a more detailed summary of this case, see Jacqueline M. Demczur, "Ontario Court Rejects Donor's Claim to Direct Gift's Allocation" *Sept 2022 Charity & NFP Law Update* (25 September 2022), online: *Carters Professional Corporation* <[https://www.carters.ca/index.php?page\\_id=538](https://www.carters.ca/index.php?page_id=538)>.

<sup>51</sup> Carter 2017, *supra* note 48 at 36.

<sup>52</sup> What is a gift?", *supra* note 43. It is stated, in relation to directed gifts, that "if the donor retains control, the donation will no longer be considered a gift at law and a receipt cannot be issued."

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.”<sup>53</sup>

The Senate Committee Report “put the spotlight on DAFs” in Canada, but its recommendation about DAFs has been criticized as conflating certain features of DAFs held by DAF Holding Charities in Canada with those of DAFs operating in the United States.<sup>54</sup> In 2018, when the Special Senate Committee on the Charitable Sector began public hearings about charitable sector reforms, DAFs were neither a priority, nor well understood. This may explain how the perception of “languishing funds” within the DAFs came about, as well as the lack of vocal push back to this recommendation at the time from various DAF Holding Charities.<sup>55</sup>

In the years since, there has been ongoing discussions, including some disagreement, within the charitable sector in Canada on the Senate Committee’s recommendation for steps to be taken to ensure funds are not “languishing” in DAFs.<sup>56</sup> These discussions on whether there are sufficient distributions being made from individual DAFs continue on to today, manifesting in three particular concerns: (1) Are DAF Holding Charities “sitting on” funds that would otherwise be used for the benefit of the larger charitable sector? (2) Are DAF Holding Charities associated with financial institutions incentivized to hold, rather than spend, charitable funds? and (3) Should the disbursement quota (“DQ”) apply at an individual DAF level or, at the very least, should there be information reported at an individual DAF level?<sup>57</sup>

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<sup>53</sup> “Catalyst for Change: A Roadmap to a Stronger Charitable Sector” *Report of the Special Senate Committee on the Charitable Sector*, (June 2019), online: *Senate of Canada* <[https://senCanada.ca/content/sen/committee/421/CSSB/Reports/CSSB\\_Report\\_Final\\_e.pdf](https://senCanada.ca/content/sen/committee/421/CSSB/Reports/CSSB_Report_Final_e.pdf)> at Recommendation 37, p. 113 [“Senate Report”].

<sup>54</sup> Malcolm D Burrows, “Donor-Advised Fund: Foundations and Borrowed Assumptions” (March 2022) 3:1 *Perspectives on Tax L & Policy*, <<https://www.ctf.ca/ctfweb/EN/Newsletters/Perspectives/2022/1/220105.aspx>> [“Burrows 2022”].

<sup>55</sup> Susan D. Phillips, Katherine Dalziel and Keith Sjogren, “Donor Advised Funds in Canada, Australia and the US: Differing Regulatory Regimes, Differing Streams of Policy Drift” (2021) 12:3 *Nonprofit Policy Forum* at p 25, <<https://doi.org/10.1515/npf-2020-0061>> [“Phillips et al”].

<sup>56</sup> Margaret H. Mason, “Is There a Need for Specific Tax Rules for Donor-Advised Funds?” (March 2022) 3:1 *Perspectives on Tax L & Policy*, <<https://www.ctf.ca/ctfweb/EN/Newsletters/Perspectives/2022/1/220104.aspx>> [“Mason”]. See also Burrows 2022, *supra* note 54, and Malcom Burrows, “Reframing ‘DAFs’ for Canada” (presentation delivered at the CAGP’s 29th National Conference on Strategic Philanthropy, Vancouver BC, 19-21 April 2023).

<sup>57</sup> See Questions from Chair of the Special Senate Committee on the Charitable Sector (8 April 2019), online: <<https://senCanada.ca/en/Committees/CSSB/NoticeOfMeeting/519719/42-1>>. See also “Budget 2022: A Plan to grow Our Economy and Make Life More Affordable” (2022), online: Her Majesty the Queen in Right of Canada <<https://www.budget.canada.ca/2022/pdf/budget-2022-en.pdf>> at p. 196 [“Budget 2022”], where the CRA was directed to “improve the collection of information from charities, including whether charities are meeting their disbursement quota, and on information related to investments and donor-advised funds held by charities.”

## a) “Languishing” assets in DAFs

The first issue deals with the perception that DAF Holding Charities are simply “sitting on” DAF assets and not distributing them out to the charitable sector in a timely enough manner (despite the donor receiving an immediate tax benefit through the charitable donation receipt).<sup>58</sup> As a result, there is a concern that donors’ gifts are being diverted to DAFs instead of being provided immediately to the larger charitable sector.<sup>59</sup> In some instances, this concern stems out of a confusion about the law as it applies to DAFs in the United States,<sup>60</sup> as DAFs in that country are subject to few legal requirements and can be used as a tax loophole for private foundations to avoid minimum payout requirements by the Internal Revenue Service.<sup>61</sup>

This, though, is not the reality of DAF Holding Charities and DAFs in Canada. By contrast, in Canada, there are minimum disbursement requirements under the ITA imposed on all registered charities,<sup>62</sup> including DAF Holding Charities (although calculated globally on all charitable assets as opposed at an individual DAF level, as explained in part c) below). There are also rules under the ITA which prohibit inter-charity transfers for the purpose of avoiding minimum payout obligations.<sup>63</sup>

Given both of these ITA safeguards, it is not entirely clear why these concerns about DAFs – specifically, whether they are paying out (or not) charitable funds in sufficient amounts – continue to be raised in the Canadian context.<sup>64</sup> There is nothing unique about the structure of DAFs that would make them particularly susceptible to criticism regarding a lack of payouts since, for example, endowments and other

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<sup>58</sup> See testimony of Ray Madoff, Professor, Law School, Boston College, to the Special Senate Committee on the Charitable Sector, (24 September 2018) online: *Senate of Canada* <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/07ev-54228-e>> [Madoff]. See also question from Senator Ratna Omidvar at the Special Senate Committee on the Charitable Sector (23 April 2018), online: *Senate of Canada* <<https://sencanada.ca/en/Content/Sen/Committee/421/CSSB/02ev-53971-e>> [Omidvar 2018].

<sup>59</sup> See Sjogren 2018, *supra* note 12.

<sup>60</sup> Burrows 2022, *supra* note 54.

<sup>61</sup> Kerry Gibbons, “Show me the Money: Addressing the Oversight Gap in Private Foundation Donations to Donor-Advised Funds” (2022) 106 *Minn L Rev* 1583.

<sup>62</sup> This minimum disbursement requirement is referred to as the “disbursement quota” or “DQ” and is explained in more detail in section D(1)(c) of this paper, including recently enacted increases to the DQ for charities with financial years starting on or after January 1, 2023. See also ITA, *supra* note 2 at s 149.1(1) definition of “disbursement quota”.

<sup>63</sup> See ITA, *supra* note 2 at ss 149.1(4.1)(a) and (b) which permits the Minister to revoke the registration of a registered charity when there are transactions, such as gifts between charities, that can be considered to have the purpose of avoiding or unduly delaying the expenditure of amounts on charitable activities.

<sup>64</sup> See also 2019 Primer, *supra* note 1 at 27-28 for a more in-depth description of the applicable provisions of the ITA.

restricted gift agreements may similarly provide a donor with an immediate tax benefit while the actual distribution of donated charitable assets for charitable purposes takes place over time.

b) Role of Financial Institutions in DAFs

A second issue in relation to those DAFs established by donors with in house foundations of financial institutions is that there may be incentives for these foundations to keep the DAF assets for as long as they can, thereby presumably allowing their affiliated financial institution to continue to provide ongoing financial services to the DAFs and receive the fees associated with such services.<sup>65</sup> DAF Holding Charities with DAFs that are managed by, or associated with, financial institutions and/or financial advisor networks tend to report the lowest flow rates (that is the relationship between donations received and grants made in any one period, with a declining flow rate leading to a retention of assets in a DAF), as well as the lowest granting frequency per individual DAF.<sup>66</sup> In house foundations linked to investment management firms were also among the least likely to impose a DQ obligation at an individual DAF level.<sup>67</sup>

Nevertheless, a lower flow rate does not mean these organizations are “sitting on” DAF assets. This could be explained by an increase in donations to DAFs (e.g. financial institutions could be receiving more donations currently than in previous years), which will subsequently flow out of these DAFs in the future and, as a result, lead to a higher flow rate at that time. In fact, the involvement of financial institutions and financial advisor networks with DAFs represents an opportunity for these entities to encourage their clients to make philanthropic donations, thereby potentially increasing the amount of money available to benefit the entire charitable sector. In this regard, DAFs (through DAF Holding Charities) provide financial advisors with a simple and effective tool with which to engage their clients in philanthropy and incentivizes them to promote giving to the charitable sector.<sup>68</sup>

c) Impact of DQ Requirements on DAF Holding Charities and DAFs

A third issue relates to the DQ and whether individual DAFs should be expected to meet it. Under the ITA, a DQ is imposed on all registered charities, including DAF Holding Charities.<sup>69</sup> The DQ is the minimum calculated amount that a registered charity is required to spend each year on its own charitable

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<sup>65</sup> See Madoff, *supra* note 58.

<sup>66</sup> CAGP Report, *supra* note 16 at 21-22

<sup>67</sup> *Ibid* at 22.

<sup>68</sup> Funk, *supra* note 31 at 6.

<sup>69</sup> ITA, *supra* note 2 at s 149.1(1).

programs or on gifts to qualified donees, such as other registered charities.<sup>70</sup> The historical purpose of the DQ has been to ensure that all charities are using sufficient amounts of their tax-receipted gifts on charitable activities/purposes, as well as to discourage charities from spending excessive amounts on fund raising and accumulating excessive funds.<sup>71</sup>

The DQ calculation is based on the value of a registered charity's property that is not used for charitable activities or administration.<sup>72</sup> There is a 3.5% DQ requirement imposed on all registered charities for such property in excess of \$25,000 (for charitable foundations) or \$100,000 (for charitable organizations) up to a value of \$1 million.

In response to concerns raised by the Special Senate Committee that there were not sufficient disbursements of charitable funds,<sup>73</sup> legislation was adopted in December 2022 so that now all such property in excess of \$1 million is subject to an increased 5% DQ,<sup>74</sup> while property below \$1 million will remain subject to the 3.5% DQ. This increased DQ requirement will impact affected registered charities, included DAF Holding Charities, with financial years starting on or after January 1, 2023.<sup>75</sup> Whether a registered charity is meeting its DQ requirement under the ITA in any year is determined based on its

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<sup>70</sup> "Disbursement quota calculation" online: *Government of Canada*

<<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/annual-spending-requirement-disbursement-quota/disbursement-quota-calculation.html>>.

<sup>71</sup> Donald Bourgeois, "What's The Law: Eliminating the Disbursement Quota: Gold or Fool's Gold?" (18 May 2010) 23:2 *The Philanthropist*, online: <<https://thephilanthropist.ca/2010/05/whats-the-law-2/>>.

<sup>72</sup> There have been several different iterations of the DQ calculation over the years, as explained in more detail in Terrance S. Carter, Jacqueline M. Demczur and Theresa L.M. Man, "Complexities of the Disbursement Quota Consultation: More Than Just a Number" *Charity & NFP Law Bulletin No. 498* (25 August 2021) online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2021/chylb498.pdf>> ["Bulletin No. 498"]. For an explanation of the steps in calculating the DQ, see Terrance S. Carter and Theresa L.M. Man, "Reminder for Charities to take the Necessary Steps to Meet the DQ" *Charity & NFP Law Bulletin No. 507* (24 February 2022), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb507.pdf>> ["Bulletin No. 507"].

<sup>73</sup> Senate Report, *supra* note 53 at 109-113.

<sup>74</sup> Terrance S. Carter, Jacqueline M. Demczur and Theresa L.M. Man, "Bill C-32 Will Increase DQ, Affect Trust Reporting, and Make Other Changes to the Income Tax Act" *Charity & NFP Law Bulletin No. 517* (23 November 2022) online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb517.pdf>>. Bill C-32 received royal assent on December 15, 2022. See also ITA, *supra* note 2 at s 149.1(1) definition of "disbursement quota".

<sup>75</sup> This means that a charity with a financial year beginning on July 1, 2023 will need to calculate the higher DQ rate for its financial year from July 1, 2023 – June 30, 2024, but will not need to apply the higher DQ rate for their financial year running from July 1, 2022 to June 30, 2023.

Note that a higher DQ rate could be challenging for certain DAFs and endowments where there are restrictions that prohibit spending capital. For more information on funding and meeting the DQ and issues to consider, see Terrance S. Carter, "Disbursement Quota Reform: Stabilizing a Three-Legged Stool" (March 2022) 3:1 *Perspectives on Tax L & Policy*, <<https://www.ctf.ca/CTFWEB/EN/NEWSLETTERS/PERSPECTIVES/2022/1/220106.aspx>>.

See also Bulletin No. 507, *supra* note 72.

disbursements on an aggregate basis, as opposed to on a fund-by-fund basis where a registered charity holds and manages individual restricted funds.<sup>76</sup>

In relation to DAFs held by DAF Holding Charities, questions have been raised about whether the CRA should examine if each and every individual DAF has been disbursing sufficient income each year,<sup>77</sup> especially in light of the funding challenges faced by charities due to pressures created by the COVID-19 pandemic.<sup>78</sup> The concern appears to be that by only imposing DQ requirements on a DAF Holding Charity on an aggregate basis, it may be possible for certain individual DAFs within the said Charity, for a period of time, to not give any of their assets to the charitable sector to fund charitable activities. This could occur where certain DAFs held by a DAF Holding Charity make large disbursements to registered charities in a particular year, thereby boosting the DAF Holding Charity's overall disbursements for the said year and fulfilling its overall annual DQ requirement.

To address this concern, one proposed option is to establish new requirements for minimum disbursements to be made by every individual DAF within DAF Holding Charities, either by imposing reasonable payout terms on DAFs over a set period of time (e.g. imposing the DQ at an individual DAF level) or, alternatively, delaying some of the tax benefits of charitable giving for donors to DAFs until the resulting DAF assets are actually gifted to the qualified donees or, now, grantee organizations as qualifying disbursements.<sup>79</sup>

However, since it is estimated that only 10% of DAFs in Canada hold assets in excess of \$1 million, imposing a DQ obligation at an individual DAF level could result in a lower overall DQ obligation than if the DQ is imposed at an aggregate DAF Holding Charity level (since a 3.5% rate applies to amounts of

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<sup>76</sup> *Income Tax Regulations*, CRC, c 945, s 3701. See also Theresa L.M. Man, "Calculation Of 3.5% Disbursement Quota for All Registered Charities" *Charity Law Bulletin No. 150* (18 December 2008) online: *Carters Professional Corporation* <<http://www.carters.ca/pub/bulletin/charity/2008/chylb150.htm>>.

<sup>77</sup> Omidvar 2018, *supra* note 58.

<sup>78</sup> Joanna Pachner, "The DAF Dilemma: Will the Pressures Created by COVID-19 Force the Federal Government to Revisit the Rules for Controversial Donor-Advised Funds?" (4 January 2021), online: *The Philanthropist Journal* <<https://thephilanthropist.ca/2021/01/the-daf-dilemma-will-the-pressures-created-by-covid-19-force-the-federal-government-to-revisit-the-rules-for-controversial-donor-advised-funds/>>.

<sup>79</sup> Madoff, *supra* note 58..

\$1 million or less, as opposed to the 5% rate for amounts in excess of \$1 million).<sup>80</sup> While there does not yet appear to be an indication that the Government will impose minimum disbursements on individual DAFs, it is possible that, at least in the more immediate term, information about individual DAFs could be required to be disclosed in a DAF Holding Charity's annual information return (T3010).<sup>81</sup>

Issues related to the disbursements made from DAFs by DAF Holding Charities remain important to monitor, including to ensure that DAF-related assets are being used and invested for the benefit of the charitable sector. Nevertheless, the average granting rate from DAFs in 2021 was 9.8% of assets, which is significantly higher than the current DQ rate (3.5% up to a maximum 5%).<sup>82</sup> Additionally, many DAF Holding Charities, including community foundations, have their own internal minimum disbursement requirements in place for each individual DAF.<sup>83</sup> On this issue, if they have not already done so, all DAF Holding Charities may wish to consider establishing an internal minimum disbursement obligation on their individual DAFs, thereby ensuring that each one is able to meet their own DQ obligation even before it ever becomes a potential requirement under the ITA.<sup>84</sup>

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<sup>80</sup> CAGP Report, *supra* note 16 at 8. The CAGP Report also indicates at page 8 that the mean average size of a DAF was \$406,000 in 2021. As an example of the point being made here, if the DQ was to be imposed on an individual DAF level, let's examine a DAF Holding Charity holding 50 individual DAFs, each with a capital value of \$400,000 as a round figure. Based on the 3.5% DQ rate for assets under \$1 million, then each individual DAF would have an annual DQ obligation of \$14,000 (3.5% x \$400,000), with the combined disbursement amount of \$700,000 (\$14,000 DQ per DAF x 50 DAFs). However, if the DQ obligation is calculated on an aggregate basis, then the said DAF Holding Charity would have an annual DQ obligation of \$985,000. This is based on total capital assets of \$20,000,000 (50 x \$400,000), with the first \$1,000,000 subject to the 3.5% DQ rate (\$35,000) and the remaining \$19,000,000 subject to the 5% DQ rate (\$950,000). Therefore, based on the now existing DQ rates, calculating the DQ at an individual DAF level in this example would result in a DQ obligation that is \$285,000 less than a DQ which is calculated on an aggregate basis.

<sup>81</sup> In an interview with Gabe Oatley from the Future of Good, Sharmila Khare, Director General of the Charities Directorate of the Canada Revenue Agency shared "I don't think we know enough as a government on the use of DAFs in the charitable sector. So, the first step will be for us to collect more information through the T3010, which will inform tax policy development in the future and compliance activities and the future. I can't speak to the specific changes at this time, but we are anticipating the revised T3010 form will be available in fall 2023." Gabe Oatley, "Full Transcript: Interview with Sharmila Khare, CRA's Director General of the Charities Directorate" (22 March 2023), online: *Future of Good* <<https://futureofgood.co/full-transcript-interview-with-sharmila-khare-cras-director-general-of-the-charities-directorate/>> ["Oatley"].

<sup>82</sup> CAGP Report, *supra* note 16 at 8.

<sup>83</sup> See Sjogren 2018, *supra* note 12.

<sup>84</sup> As pointed out in Bulletin No. 498, *supra* note 72 at 6, if the DQ applied at an individual fund level, it could have unintended consequences for both DAFs and other non-DAF restricted funds, particularly endowments, held and administered by non-DAF Holding Charities. Such endowments may or may not have the ability on an individual basis to meet the applicable DQ requirement, particularly where they are historic and may only be authorized to calculate income based on the common law definition as opposed to on a total return basis.]

## 2. Issues Related to Qualifying Disbursements and Anti-Directed Giving Provisions

### a) Overview of Qualifying Disbursements

In June 2022, changes were made to the ITA to enable charities to distribute their charitable property in a greater variety of circumstances.<sup>85</sup> Specifically, registered charities are now permitted to make “qualifying disbursements” to “grantee organizations”. By way of background, a “qualifying disbursement” is a disbursement by a charity by way of gift or by otherwise making resources available, while a “grantee organization” includes a person, club, society, association or organization or prescribed entity (but not a qualified donee).<sup>86</sup> As a result of these changes, registered charities, including DAF Holding Charities, can now provide different resources (e.g. money, space in a building) to a greater variety of entities (e.g. to a qualified donee, such as a registered charity, or to a grantee organization, such as a non-profit organization).

However, DAF Holding Charities (as well as charitable foundations more generally) should be aware of the potential impediments associated with these expanded giving options. First, a DAF Holding Charity could only make a qualifying disbursement to a grantee organization if:

(a) the disbursement is in furtherance of the DAF Holding Charity’s own charitable purposes [“Requirement (a)”],

(b) if it ensures that the disbursement is exclusively applied by the grantee organization to charitable activities which further the DAF Holding Charity’s own charitable purposes [“Requirement (b)”], and

(c) the DAF Holding Charity maintains documentation sufficient to demonstrate both (a) and (b) [“Requirement (c)”].<sup>87</sup>

Second, it is important to be aware that only qualifying disbursements which are gifts made to grantee organizations will count towards meeting a DAF Holding Charity’s DQ obligations. If qualifying

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<sup>85</sup> For information about the background to these legislative changes, and an overview of the contents of the act that implemented these changes, see Terrance S. Carter and Theresa L.M. Man, “Bill C-19 *Budget Implementation Act, 2022, No. 1* Proposes Major Changes to Legislative Framework Governing Charities” *Charity & NFP Law Bulletin No. 511* (25 May 2022), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb511.pdf>>. See also, by the same authors, “Bill C-19 is Amended to Simplify Funding of Non-Qualified Donees” *Charity & NFP Law Bulletin No. 513* (28 June 2022), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb513.pdf>>.

<sup>86</sup> ITA, *supra* note 2 at s 149.1(1) definitions of “grantee organization” and “qualifying disbursement”.

<sup>87</sup> *Ibid* at s 149.1(1) definition of “qualifying disbursement” at (b).

disbursements are made to grantee organizations (either from the Charity's DAFs or other charitable property) that constitute "otherwise making resources available", they will not count towards fulfilling the applicable DQ requirements.<sup>88</sup>

#### b) Possible Amendment of Charitable Purposes before Making Qualifying Disbursements

Because a DAF Holding Charity must meet the requirements in the ITA for making qualifying disbursements to grantee organizations, as a practical implication, if a DAF Holding Charity's current charitable purpose is limited to making gifts to qualified donees, then it will not be able to make qualifying disbursements to grantee organizations. This is because the DAF Holding Charity cannot fulfil Requirement (a) since its current charitable purpose does not provide the authority to carry out any "active" charitable purposes, i.e. which are to be achieved through "active" charitable programs either carried on by the Charity itself or by grantee organizations through qualifying disbursements (thereby fulfilling Requirement (b)).<sup>89</sup> In addition, as an additional practical concern related to Requirement (c), it is not yet clear what "sufficient" documentation will entail, pending the release of a finalized guidance about qualifying disbursements from the CRA.<sup>90</sup>

As such, in order to be eligible to make qualifying disbursements, the DAF Holding Charity may first need to amend its existing charitable purposes to add one or more new ones which are active in nature, e.g. operating scholarship programs or conducting educational programs.<sup>91</sup> However, this takes time and

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<sup>88</sup> Terrance S. Carter, Theresa L.M. Man & Lynne M. Westerhof, "CRA Releases Draft Guidance on Charities Making Grants as Qualifying Disbursements" *Charity & NFP Law Bulletin No. 518* (7 December 2022), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb518.pdf>> at 11-13 ["Bulletin No. 518"].

<sup>89</sup> It is not clear if the CRA will allow for an "omnibus purpose" of permitting charities to make qualifying disbursements to grantee organizations, or if, for example, a charity would need to have a purpose of the relief of poverty in order to make a gift to a grantee organization that assists the homeless. See Letter from Kate Bake-Patterson, Chair of the Canadian Bar Association Charities and Not-for-Profit Law Section to the Charities Directorate, Canada Revenue Agency (6 February 2023), "Re: Draft Guidance on Registered charities making grants to non-qualified donees" online: <<https://www.cba.org/CMSPages/GetFile.aspx?guid=590961a6-acd4-4d21-bccb-f800c6ecc53c>> ["CBA Letter"].

<sup>90</sup> The CRA released draft guidance about qualifying disbursements in November 2022. The deadline to provide feedback on this draft guidance was January 31, 2023. A final version of the guidance is expected to be released in the upcoming months. See "Registered charities making grants to non-qualified donees (draft)" CRA Guidance CG-032 (30 November 2022), online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/charities-making-grants-non-qualified-donees.html>> ["Draft CG-032"]. See also Bulletin No. 518, *supra* note 88 and Oatley, *supra* note 81.

<sup>91</sup> See Oatley, *supra* note 81 where it was indicated by the CRA (somewhat indirectly) that charitable foundations with the purpose of "providing support to qualified donees" may need to update their charitable purposes to make gifts to grantee organizations. The questions, asked by Gabe Oatley from the Future of Good, and the responses of Sharmila Khare, the Director General of the Charities Directorate of the CRA are provided below for context:

"[Gabe] Some have expressed concern that many foundations, particularly those whose charitable purposes are focused on "providing support to qualified donees," might need to amend their charitable purposes to be allowed to leverage this new way of working with non-qualified donees. What is your perspective on that?"

resources on the DAF Holding Charity's part, first to amend its corporate documents to add in the new purposes, as well as to submit them, together with an updated statement of activities, to the CRA and wait for its review and approval.

On this issue, suggestions have been made to the CRA by the charitable sector that it be open to accepting an "omnibus" type of purpose, i.e. something relatively simple such as "offer grants to non-qualified donees".<sup>92</sup> It remains to be seen if this approach will be acceptable to the CRA or if, instead, a detailed list of new "active" charitable purposes will have to be put in place before DAF Holding Charities are able to make qualifying disbursements.

However, on this issue, DAF Holding Charities which are incorporated in Ontario<sup>93</sup> must also consider whether they would be required to add an after-acquired clause to their corporate documents. The "after acquired clause" is a clause that must be included in the articles of amendment of any Ontario not-for-profit corporation/registered charity which amends its charitable purposes.<sup>94</sup> While there are certain limited exceptions to this default rule,<sup>95</sup> these exceptions will not apply unless the consent of the Ontario Public Guardian and Trustee ("PGT") is obtained to omit the after-acquired clause in the articles of amendment.

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[Sharmila] I think that is an important consideration that's come up through the consultation process. We will be providing a little bit more guidance to the sector on how they can update their charitable purposes. Because at the end of the day, the charity needs to be able to demonstrate that resources were used to further their stated charitable purposes. It's important for any charity to ensure that their purposes reflect the type of work they're engaged in today.

[Gabe] So that will need to be updated for foundations for whom their stated charitable purposes are supporting qualified donees — they will have to make that change?

[Sharmila] It will always depend on the particular fact and what the charitable purposes of any foundation currently look like, but it is likely that some adjustments will need to be made."

<sup>92</sup> See CBA Letter, *supra* note 89.

<sup>93</sup> This encompasses all registered charities under the ITA which are also not-for-profit corporations in Ontario, whether originally incorporated under the *Corporations Act* (Ontario) ("OCA") or its successor legislation, the *Not-for-Profit Corporations Act, 2010* (Ontario) ("ONCA"). As of October 18, 2021, the ONCA replaced the OCA and commenced the start of a three-year transition period for OCA corporations to amend their corporate documents to come into compliance with the more detailed ONCA requirements.

<sup>94</sup>Not for Profit Incorporator's Handbook, online: *Office of the Public Guardian and Trustee / Ministry of the Attorney General of Ontario* <[https://www.publications.gov.on.ca/store/20170501121/Free\\_Download\\_Files/300775.pdf](https://www.publications.gov.on.ca/store/20170501121/Free_Download_Files/300775.pdf)> at 52-53. On page 52, the Office of the Public Guardian and Trustee states: "If the charity wishes to change its purposes as part of an application, e.g. articles of amendment, note that, as a general principle, once charitable purposes are declared, they can only be changed in limited circumstances."

The wording of the default after acquired clause is as follows: "All funds and other property held by the corporation immediately before the articles become effective or that are received subsequently by the corporation pursuant to any will, deed or other instrument made before the articles become effective, together with any income or other accretions to the funds or other property, will be applied only to the purposes of the corporation as they were immediately before the articles become effective."

<sup>95</sup> *Ibid* at 52.

At this point in time, it is unclear whether the PGT may (or may not) be agreeable to consent to omit the after acquired clause in the particular situation of a DAF Holding Charity (or other applicable registered charity) seeking to add a new purpose(s) in order to be able to make qualifying disbursements to grantee organizations. However, failing receipt of this PGT's consent, then the after acquired clause must be included in any articles of amendment of any Ontario-incorporated DAF Holding Charities. This will, in turn, result in only those funds or other property acquired by such charities after the articles of amendment became effective to be able to be used for the new charitable purpose(s).<sup>96</sup>

### c) Anti-Directed Giving Provisions

In addition, DAF Holding Charities that wish to make gifts to grantee organizations need to be aware of paragraph 168(1)(f), a provision that was also amended in June 2022. This provision (sometimes referred to as the “directed giving” provision) reads as follows:

168 (1) The Minister may, by registered mail, give notice to a person described in any of paragraphs (a) to (c) of the definition qualified donee in subsection 149.1(1) that the Minister proposes to revoke its registration if the person [...]

(f) in the case of a registered charity, [...] 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.<sup>97</sup>

At this point in time, it is not clear what is considered to be “implicitly conditional” and this issue is not specifically addressed in the November 2022 draft CRA Guidance on qualifying disbursements (“CRA QD Guidance”).<sup>98</sup> Accordingly, it is uncertain at best what transactions could be potentially characterized as “implicitly conditional” gifts. On this issue, the CRA QD Draft Guidance only indicates that if “a charity ensures it retains authority on the use of its resources, it will not be considered to be engaged in directed giving.”<sup>99</sup>

In addition, these new directed giving provisions are yet another reason for DAF Holding Charities to ensure that they clarify with their donors upfront that they are not obligated to make any gifts from DAFs based on donor advice or recommendations, and that they are solely responsible to decide if, how and in what quantum gifts are made from the DAFs. This is consistent with the CRA's own advice on the matter

<sup>96</sup> *Ibid* at 53.

<sup>97</sup> ITA, *supra* note 2 at s 168(1)(f).

<sup>98</sup> See Draft CG-032, *supra* note 90 at s 7.4 “Directed Gifts and Acting as a Conduit”.

<sup>99</sup> *Ibid*.

in the context of directed giving. Specifically the CRA has advised that, in order to avoid being offside of the new anti-directed giving rules, a charity should clearly communicate to donors on its website and in its fundraising materials that: (1) donors can express their preference for how a charity will apply their gift, but the charity has final say on how it uses its resources; and (2) if the charity does not use the gift in the way the donor prefers, the charity will not return the gift to the donor.<sup>100</sup>

However, many in the charitable sector are of the view that it would be helpful if the directed giving provision was amended, or, at the very least, if it were clarified what actions will be sufficient to insulate a registered charity from any allegations of facilitating directed giving.<sup>101</sup> It will be interesting to see what the final version of CRA QD Guidance may say on this issue to hopefully clarify its scope and application. Until then though, DAF Holding Charities are well advised to plan carefully and tread cautiously as they contemplate whether or not to move into this new qualifying disbursement regime.

### 3. Importance of Having a Granting Policy or Guidelines in Place

A related issue to DAF Holding Charities not being involved in directed giving or providing too much donor “control” over DAFs, is ensuring that the ongoing gifts being made to qualified donees from DAFs are themselves not offside of the requirements of either the ITA or applicable CRA administrative policies. Being offside could expose a DAF Holding Charity to potential complaints, compliance audits and, depending on the audit results, possible penalties and/or sanctions being issued by the CRA, including revocation of charitable registration if the level of non-compliance is significant.

Depending on the particular background and features of a DAF Holding Charity, it may be that it will want to place limitations on the type of qualified donees that it will make gifts to from the DAFs that it holds and administers. Such limitations could include, but are not limited to, geographic restrictions (e.g. gifts can only be made to qualified donee in a particular geographic city, region or province), religious restrictions (e.g. gifts can be made only to charities associated with a particular religious faith and not to other religious faiths or secular organizations), cultural or philosophical restrictions (e.g. gifts cannot be made to charities associated with or supportive of certain causes) or program-based restrictions (e.g. gifts are limited to charities working in a particular program area such as arts or the environment).

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<sup>100</sup> *Ibid.*

<sup>101</sup> See CBA Letter, *supra* note 89 at 4.

DAF Holding Charities that have limitations or restrictions in place of this nature, particularly where they are set out directly in their charitable purposes, will need to put appropriate policies or guidelines in place to ensure that all DAF gift recommendations provided by donors/fund advisors fit within their parameters. Each DAF Holding Charity should clearly identify in these policies or guidelines which types of qualified donees, either directly through their own programs or as a result of their affiliations, do not fall within the Charity's charitable purposes, values or, if applicable, statement of faith, and are not eligible to receive gifts from the DAFs. All such decisions must be those of the DAF Holding Charity alone in its sole discretion.

In addition, any such granting policy or guidelines should also make clear that the DAF Holding Charity, as a registered charity subject to the ITA, is not permitted to make gifts from DAFs to any of the following:

- a) a non-qualified donee, including non-profit organization, subject now to the possible exception of qualifying disbursements to grantee organizations;
- b) a qualified donee where the DAF Holding Charity is aware that the said gift may be used by the said qualified donee for a non-charitable purpose or will confer an advantage or other private benefit to the DAF's donor/fund advisor or any person who is not at arm's length from them for the purposes of the ITA;<sup>102</sup>
- c) individuals or families; and/or
- d) political candidates or parties.

There may also be requirements set out in the granting policy or guidelines on the minimum or maximum amounts for any gift made from a DAF, as well as the minimum or maximum number of gifts that can be made from the DAF during a set time period, *e.g.* each quarter or each calendar/financial year.

#### 4. Impact of Alternative Minimum Tax

Budget 2023 proposed to make changes to the federal alternative minimum tax ("AMT") which could impact high-net worth individuals and, in turn, impact the planned donations that such individuals may

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<sup>102</sup> Such advantages or other private benefit could include the payment of membership fees or dues, goods purchased for or relation to charitable fundraising, *e.g.* tickets to a fundraising dinner or event, or tuition fees.

make to registered charities, including DAF Holding Charities.<sup>103</sup> Taxpayers are required to calculate their tax liability under the “regular” method and under the AMT. If a taxpayer has claimed preferential tax deductions resulting in a low tax liability under the regular method, then they will have to pay the higher AMT, as a way of ensuring that every individual pays at least a minimum amount of tax.<sup>104</sup> The AMT changes are proposed to come into force for taxation years that begin after 2023.<sup>105</sup>

The AMT rate is proposed to increase from 15% to 20.5% and, importantly for charities, it may include 30% of the capital gains on donations of publicly listed securities.<sup>106</sup> Currently, an individual may donate publicly listed securities to a charity and, in so doing, will not realize any capital gains on their disposition. This provides the donor with a greater tax benefit than if the donor had sold the publicly listed securities and then donated the proceeds to a charity. This is because when a donor sells the publicly listed securities on their own, they are personally liable for tax owed on capital gains. However, when the donor gifts the publicly listed securities to a registered charity, they do not owe this capital gains tax but still receive a donation receipt for the full value of the gift.

If the changes to the AMT proposed in Budget 2023, particularly in relation to the 30% capital gains tax on donations of publicly listed securities, are passed into law, then donors will not receive as great of a tax benefit for the donation of publicly listed securities to charities and may consider alternate tax planning methods. This could lead to a decrease in donations to the charitable sector after 2023, including those made to DAFs. Nevertheless, it remains to be seen if the 30% capital gains tax will be included in any future budget implementation legislation, and if so, what the practical effects of this measure might be on DAF-related charitable donations made to DAF Holding Charities.

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<sup>103</sup> For an overview of the alternative minimum tax, see Amanda J. Stacey & Troy McEachren, “Budget 2023 and changes to the alternative minimum tax: Be careful when donating publicly listed securities” *Social Impact Newsletter* (18 April 2023), online: *Miller Thomson LLP* <<https://www.millertomson.com/en/publications/communiqués-et-mises-à-jour/newsletter-social-impact/april-18-2023/budget-2023-changes-alternative-minimum-tax-donating-publicly-listed-securities/>>.

<sup>104</sup> “Alternative Minimum Tax” *The Navigator* (August 2018), online: *RBC Wealth Management* <<https://ca.rbcwealthmanagement.com/documents/634020/2239538/The+Navigator+-+Alternative+Minimum+Tax+%28AMT%29.pdf/792f7c61-e95c-4266-a1b2-cd1fe26823ab>>.

<sup>105</sup> “Budget 2023: Tax Measures: Supplementary Information” (2023), online: *His Majesty in Right of Canada* <<https://www.budget.canada.ca/2023/report-rapport/tm-mf-en.html#a18>> [“Budget 2023 Tax Measures”].

<sup>106</sup> *Ibid.* See also “Budget 2023: A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy Future” (2023), online: *His Majesty in Right of Canada* <<https://www.budget.canada.ca/2023/report-rapport/chap6-en.html#a4>> at 6.3.

## 5. Successors / Heirs of DAF Advisors

As more people establish and donate to DAFs, questions arise as to how DAFs are to be treated within a DAF Holding Charity upon the passing of the original DAF donor. As demonstrated in the case of *The Joseph Lebovic Charitable Foundation v. Jewish Foundation*,<sup>107</sup> summarized in Section C.4 above, after the passing of a DAF donor, a DAF Holding Charity may continue to receive recommendations about distributions from the DAF, likely from a family member or other successor of the DAF donor. There are many potential issues that a DAF Holding Charity should consider in relation to DAF successors, including what to do if the donor does not designate a successor or if multiple successors give contrary recommendations.<sup>108</sup> Further, a DAF Holding Charity should consider when successor's rights will extinguish (e.g. can a successor appoint a subsequent successor?), as well as what the Charity will do with any funds remaining in the DAF at that point.<sup>109</sup>

Similar consideration should be given to situations in which the original DAF donor is not an individual, e.g. a DAF may be started by a group of unrelated people, a partnership, corporation or association.<sup>110</sup>

## 6. Impact of “Anonymous” Donations from DAFs to Registered Charities

One feature of DAFs that may be a challenge for recipient charities is that DAFs allow donors to maintain anonymity when gifts are made by a DAF Holding Charity (after considering the recommendations of the donor). Recipient charities view anonymity and dealing with an intermediary (i.e. the DAF Holding Charity) as issues which may act as barriers to the proper acknowledgement of gifts and development of relationships with donors.<sup>111</sup> If recipient charities do not have direct communication with the donor who established the DAF, it may be difficult for these charities to keep the donor informed about the effectiveness of the gifts made from the DAF.<sup>112</sup> Also, there may be instances in which it is important for

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<sup>107</sup> *Joseph Lebovic*, *supra* note 49.

<sup>108</sup> Kate Bake-Paterson & Calvin Fong, “Donor Advised Funds: Life and Death” (presentation delivered at the CAGP’s 29th National Conference on Strategic Philanthropy, Vancouver BC, 19-21 April 2023) at slides 26-29.

<sup>109</sup> Some DAF agreements have “sunset provisions” included which indicate how funds are to be disbursed in the absence of a successor. For example, funds may be disbursed in accordance with the donor’s historical giving patterns. See “Donor-advised Funds: The Intersection of Philanthropy and Wealth Management” (6 November 2018), online: *Strategic Insight / SI Research* <<https://www.investoreconomics.com/reports/donor-advised-funds-the-intersection-of-philanthropy-and-wealth-management/>> at 9.

<sup>110</sup> CAGP Report, *supra* note 16 at 5

<sup>111</sup> *Ibid* at 34. See also Phillips et al, *supra* note 55 at 19-20.

<sup>112</sup> Ian Murray, “Donor Advised Funds: What Can North America Learn From the Australian Approach?” (2020) 6 Can J of Comparative & Contemporary L 260 at 274 <<https://www.cjcl.ca/wp-content/uploads/2020/11/8-Murray.pdf>>.

a recipient charity to know the identity of the donor of a gift, such as when a charity must be sensitive to allegations or the appearance of foreign interference or conflicts of interest.

#### 7. Uncertain Application of New Trust Reporting Rules

As explained earlier in this paper, a DAF is a common type of charitable giving vehicle. In some circumstances, a donor may impose express restrictions on the DAF at the time when it is first established and the initial gift made, namely ones which are over and above the general direction that the gift is to be held in the DAF. These express restrictions can relate to the length of time a DAF's capital is to be held, the restricted use purpose(s) for which capital and/or income are to be used, or both.

For example, a donor could establish a DAF with a DAF Holding Charity subject to a restriction that, for the initial five years after the DAF is set up, the capital from both the original gift and any additional ones cannot be expended and only the income generated by the capital utilized to make gifts to qualified donees. These types of donor restriction would serve to make the DAF (and gifts made to it) donor restricted charitable gifts, as explained in section C.2. which could then mean that the DAF (and gifts made to it) may be considered to be held in trust by the DAF Holding Charity. If a charity accepts a gift subject to a restricted charitable purpose trust, then it is legally bound to comply with those restrictions and fully understand the implications of not doing so.

DAF Holding Charities, therefore, should be aware of new trust reporting requirements currently in effect for taxation years ending after December 30, 2023.<sup>113</sup> Subsection 150(1.2) of the ITA narrows the situations in which an entity will not have to file a trust return of income ("T3"). In the past, it has been the CRA's long-standing administrative policy that it does not require internal trusts of charities to file separate trust returns (e.g. a university that holds multiple endowments would not need to report on each endowment through a separate T3).<sup>114</sup> However, with the addition of subsection 150(1.2), it is unclear whether registered charities (including DAF Holding Charities) holding internal express trust would be

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<sup>113</sup> Changes were made to subsection 150(1.1) of the ITA and subsection 150(1.2) was added to the ITA by Bill C-32, *Fall Economic Statement Implementation Act, 2022*, 1st Sess, 44th Parl, 2022 (royal assent on December 15, 2022).

<sup>114</sup> Terrance S. Carter, Theresa L.M. Man, and Jacqueline M. Demczur, "Draft Budget Implementation Legislation will Increase DQ and Affect Trust Reporting" *Charity & NFP Law Bulletin No. 515* (24 August 2022), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb515.pdf>> at 7-9.

subject to the new trust reporting requirements and, if so, what filings would need to be made the CRA under these new rules.

## **E. HOW TO WORK WITH DAFs**

### **1. Properly Establishing and Managing DAFs**

Difficulties can arise with DAFs if there is either a lack of understanding of what a DAF is at law and how it is required to legally operate once established, or if there is a failure on the part of both DAF Holding Charities and their donors to implement appropriate practices in the day-to-day operation of a DAF. Given that this topic could itself be the subject of an entire paper, this section is only intended to provide some initial comments on these issues for the reader's consideration.

As referenced above, the key to successfully establishing and managing a DAF is to ensure that, first, ownership of the DAF and all of its assets is held by the DAF Holding Charity and, second, that the DAF Holding Charity retains control over all decisions associated with the fund, including investing and ongoing gift making to qualified donees (and grantee organizations, as applicable). In this regard, the DAF Holding Charity must ensure that it takes all necessary steps to appropriately advise its donors, both initially and on an ongoing basis, that their input in relation to the DAF can be of an advisory nature only.

To evidence that the DAF Holding Charity has properly advised the donors of their advisory role regarding the DAF, the documents creating any DAF must clearly state that it is the DAF Holding Charity which administers the fund and that the DAF Holding Charity explicitly reserves the right to not follow the donor's suggestions, advisements, or recommendations regarding how monies in the fund are to be distributed or applied by the DAF Holding Charity.<sup>115</sup> Although not an exhaustive list, this gift agreement establishing the DAF could also address the following issues:

- (1) the name of the DAF;
- (2) the minimum initial amount required to establish the DAF;<sup>116</sup>

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<sup>115</sup> Carter 2017, *supra* note 48 at 37.

<sup>116</sup> Charities should be aware that while DAF funds with small minimum balances enable a greater range of people to participate in DAFs, there still needs to be thought given to the accounting and administrative costs associated with each DAF so as to avoid operating DAFs at a net loss. Mason, *supra* note 56.

- (3) the amount of time that a donor has to contribute gifts in order to reach this minimum amount and what will happen if the minimum amount is not achieved by the donor;
- (4) the fees that will be charged in relation to administering the DAF and its investments;<sup>117</sup>
- (5) how often gifts to qualified donees will be made from the DAF assets by the charity and in what minimum amount per year;<sup>118</sup>
- (6) if desired by the donor, the general parameters of the type of qualified donees to be recipients of gifts from the DAF;<sup>119</sup>
- (7) the manner and how often the donor's advice on the recipients of gifts from the DAF will be sought;
- (8) if and how the donor is permitted to appoint a successor advisor for the DAF;
- (9) any special investment powers to be provided to the charity in relation to the DAF assets;<sup>120</sup> and
- (10) if desired, a requirement that the donor's advice (but not approval) be sought if the charity decides to transfer the DAF to another registered charity through a change of trustee in accordance with the *Trustee Act* (Ontario).

The gift agreement establishing the DAF should originate from the DAF Holding Charity itself based upon input from its legal counsel, be thoroughly reviewed with the donor who should then obtain independent legal advice regarding the agreement's terms, and thereafter be signed by both of the parties. In so doing, this agreement will properly document the giving of the initial gift by the donor, but also

<sup>117</sup> DAFs have been observed to involve "higher administrative costs than other kinds of donated funds because of the staff time required to manage the donor relationship" and because they require "a more sophisticated employee skill set from the charity's employees." Therefore, a DAF Holding Charity will wish to accurately account for these costs when setting fees. *Ibid.*

Charities tend to charge fees as a percentage of the overall amount held in a DAF (with lower fees for DAFs with higher balances) and may also charge a monthly or quarterly flat fee for administrative costs. See, e.g. Benefaction DAF

[https://static1.squarespace.com/static/611448fc5fb0a37e0a7a19ae/t/6149f0ec3d62f045956cef2b/1632235756271/DAF+Program+vs++Private+Foundation\\_2021.pdf](https://static1.squarespace.com/static/611448fc5fb0a37e0a7a19ae/t/6149f0ec3d62f045956cef2b/1632235756271/DAF+Program+vs++Private+Foundation_2021.pdf)

Sometimes the percentage fees are separately billed as administrative fees and investment management fees. See, e.g. Winnipeg Foundation [https://www.wpgfdn.org/wp-content/uploads/2020/01/Finance\\_-\\_Fee\\_Policy.pdf](https://www.wpgfdn.org/wp-content/uploads/2020/01/Finance_-_Fee_Policy.pdf)

Fees may be significantly higher for small donations. See e.g. Makeway Foundation's donor-advised Giving Fund which has a minimum opening donation of \$5,000 and will apply costs of 6% on donations of less than \$1,000 (by way of contrast, donations of more than \$1,000 to the same fund will have a lower cost of 1.75% of their value). <https://makeway.org/solutions/advised-funds/>

<sup>118</sup> For example, the Private Giving Foundation (associated with TD bank) has a limit of 5 grants per year, to be made annually. <https://www.td.com/ca/document/PDF/tdw-pgf-program-guide.pdf> at 6.

Gift Funds Canada (associated with RBC) has a minimum grant amount of \$250. See

[https://www.giftfunds.com/site/templates/pdfs/CGFCF\\_-\\_Donor\\_Program\\_Guide\\_R0118.pdf](https://www.giftfunds.com/site/templates/pdfs/CGFCF_-_Donor_Program_Guide_R0118.pdf) at 17.

<sup>119</sup> The donor may wish to impose such restrictions from the outset in the event that the donor does not provide their advice in a particular year or if such donor advice is not followed by the charity upon receipt from the donor for any reason. If this step is taken by the donor, then, this would also serve to turn the gift to the DAF into a restricted charitable purpose trust. In so doing, the donor will have general assurance that the annual gifts from the DAF are being given to qualified donees within the parameters of their said restriction.

<sup>120</sup> This is another example of a possible donor restriction that could be imposed by the donor at the outset, turning the DAF into a special purpose charitable trust.

crystallize the restricted terms of the DAF as agreed upon by the parties. This written agreement will also ensure that the donor was fully advised of the limited nature of advice that he/she will be able to provide to the DAF Holding Charity and that the ultimate decision-making authority over the DAF belongs to the DAF Holding Charity. This is absolutely necessary to ensure that the donations made by the donor to the DAF are true gifts at law and can be receipted as such under the ITA.

Once a decision has been made to accept a gift from the donor to establish a DAF, then the DAF Holding Charity and its management must be careful to ensure that the DAFs are properly managed in accordance with all applicable legal requirements. Appropriate management would involve the following steps:<sup>121</sup>

- (1) comply with all donor restrictions, as well as any donor advice requirements set out in the gift agreement, as well as reporting back requirements to the donor;
- (2) ensure that each DAF is tracked and managed by the DAF Holding Charity separately from any other DAFs or other restricted trust funds that it may hold;
- (3) ensure that the assets in the DAF are invested in accordance with the specific investment powers set out in the gift agreement or, if there is no special investment power, in accordance with the general investment powers of the charity;
- (4) ensure that each DAF, together with any other DAFs and restricted trust funds held by the charity, are not commingled with its general funds, with recognition that a DAF can be commingled with other DAFs and restricted trust funds for investment purposes subject to any special investment powers applicable to certain funds;<sup>122</sup>
- (5) properly report gifts made from a DAF to a qualified donee on a DAF Holding Charity's annual T3010;<sup>123</sup>
- (6) maintain all non-public personal donor information in strict confidentiality and security;
- (7) be aware that the proceeds from the sale of charitable property held in a DAF remain impressed with the same donor restrictions imposed at the time the DAF was originally established; and
- (8) ensure that any transfer of a DAF over to another charity must be done by way of a written appointment in accordance with section 3 of the *Trustee Act* (Ontario) to document the change of trustee.

<sup>121</sup> Carter 2006, *supra* note 38 at 85-86.

<sup>122</sup> See, for example, *Approved Acts of Executors and Trustees*, O Reg 4/01, s 3, for regulations on commingling funds in Ontario.

<sup>123</sup> This is done at line 5050 of the T3010 itself, as well as by the DAF charity completing Form 1236 to the T3010, entitled *Qualified Donees Worksheet/Amounts Provided to Other Organization*.

## 2. Practical Advice for Advising Clients

In terms of practical advice for legal practitioners working with their registered charity clients on DAFs, the following recommendations should be considered:

- a) Do your homework ahead of time – Take the time and do the appropriate due diligence to figure out how to do DAFs right from the outset, and advise your charity clients accordingly. Some due diligence best practice suggestions that you may recommend and work with your clients to put in place in relation to DAFs include: (i) developing and implementing written gift acceptance policies addressing DAFs among other gifting vehicles; (ii) utilizing checklists to ensure consistent treatment of gifts to DAFs; (iii) encouraging clear communications with donors before gifts to DAFs are made; (iv) preparing appropriate gift agreements to establish DAFs; and (v) then advising the charity how to manage and administer DAFs correctly in accordance with their obligations under the ITA.<sup>124</sup> If DAFs cannot be established and administered legally by either the charity or any of its donors, then they should not be done at all.
- b) Create templates – Any charity interested in receiving gifts through DAFs are strongly advised to create their own template documents to do so, as well as systems for their management on a day to day basis. Legal counsel should be prepared to discuss the need for and importance of template gift agreements and related documents with their charity clients and draft appropriate templates in accordance with the charity’s needs.
- c) Ensure that the Charity Runs the Process – The charity with assistance from its legal counsel as needed, and not the donor or their legal counsel, should be in control in establishing DAFs, utilizing consistent procedures as set out in policy together with template gift agreements.
- d) Be Vigilant – Any charity considering receiving gifts of DAFs needs to be aware of how things can go awry and avoid them entirely, e.g. avoid referring to DAFs as “accounts” or that donors are “clients”, engaging in any marketing or communications which suggest that a DAF “belongs” to the donor, that the donor makes all decisions in relation to the DAF or that the DAF is the donor’s

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<sup>124</sup> Terrance S. Carter and Theresa L.M. Man, “When is a Gift Not a Gift? And What to Do when Gifts Go Bad?” (Carters/Fasken Martineau Healthcare Philanthropy Check-Up 2016), online: *Carters Professional Corporation* <<http://www.carters.ca/pub/seminar/charity/2016/Handout-When-is-a-Gift-Not-a-Gift.pdf>> at slides 61-66.

own “private foundation”.<sup>125</sup> Legal practitioners need to be aware of these potential issues as well in order to properly advise their charity clients on how to avoid future problems with DAFs.

- e) Identify Opportunities – The use of DAFs represents an opportunity for ongoing engagement with donors. Registered charities and their legal counsel should consider the many ways that DAFs represent a new way to interact with donors and keep them interested in the continuing work of the charity. For example, a hospital foundation that sets up DAFs to benefit a particular hospital could engage with DAF donors annually about new initiatives to benefit the hospital (e.g. fundraising for new MRI machines or responding to a viral epidemic). Alternatively, the donor may wish to make a gift to the hospital for its surgical department one year, and in the next year may wish for their gift to improve the hospital’s emergency room.

In this situation, donor may make a large, one-time gift to a DAF for the benefit of the hospital, but they do not have to decide at the time of the gift how, specifically, those funds are to be spent. The donor and potentially the donor’s successors may provide ongoing recommendations to the hospital foundation as to how the DAF funds are to be used and can decide to assist the hospital with any pressing needs that arise unexpectedly.

## **F. CONCLUSION**

DAFs that are properly set up and operated correctly can be very helpful in facilitating gifts for the charitable sector and, as such, a charity should consider whether DAFs might be worthwhile to make available to its donors. However, before a charity or a donor becomes involved in a DAF, it is essential that both parties clearly understand what it is at law, how it must be properly established as a legal charitable gift in order that a charitable donation receipt can be issued in exchange for the gift, and how the DAF is to operate, from a functional standpoint, within the DAF Holding Charity on a day-to-day basis. If all legal aspects of a DAF are not complied with, then the donor’s gifts to it might be potentially invalidated and either preclude a charitable donation receipt being issued at the time of the gift or, worse yet, potentially see the said receipt being invalidated by the CRA at a future date.

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<sup>125</sup> Margaret Mason, “Knowing Your Donor and Money Laundering” (PowerPoint presentation, April 2018) at slides 17-18. This power point presentation also addresses other areas of confusion with DAFs in addition to marketing communications.

DAFs in Canada will likely continue to grow in number and overall dollar value, if recent trends are any indication.<sup>126</sup> Given the potential for misunderstandings about who controls the funds in a DAF, as well as recent changes to the ITA, registered charities, donors and legal counsel need to be aware of the legal underpinnings of DAFs as well as the current context of DAFs in Canada. It has been the intention with this paper to further the reader's understanding of these issues and it is hoped that this intention has been achieved.



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<sup>126</sup> CAGP Report, *supra* note 16 at 8, 38.