

 <p>BARRISTERS SOLICITORS TRADEMARK AGENTS</p>	<p>The Annual Church & Charity Law™ Webinar Continues Virtually November 4, 2021</p>
<p>Donor Advised Funds for Churches and Charities</p> <p>By Jacqueline M. Demczur, B.A., LL.B. jdemczur@carters.ca 1-877-942-0001</p> <p>© 2021 Carters Professional Corporation</p>	
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<p>OVERVIEW OF TOPICS</p> <ul style="list-style-type: none">• Introduction• History, Development and Current Size• What is a DAF at Law?• Current Issues Associated with DAFs• How to Work with DAFs• Conclusion <p>– For more information, see the May 6, 2019 paper, “Primer on Donor Advised Funds and Current Issues”: https://www.carters.ca/pub/seminar/charity/2019/Paper-Primer-or-Donor-Advised-Funds-and-Current-Issues-Jacqueline-Demczur-2019-05-06.pdf</p>	
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A. INTRODUCTION

- Donor Advised Funds (“DAFs”) have attracted much attention over the last few years
- DAFs that are properly set up and operated can be helpful in facilitating gifts for the charitable sector
- The flexibility in structuring DAFs is one reason why their use has grown significantly in Canada over the last 20+ years
- However, misconceptions exist about what DAFs are at law, how they are legally established and administered, and the level of donor control over them
- If DAFs are not operated properly, they may continue to generate unnecessary scrutiny from regulators

B. HISTORY, DEVELOPMENT AND CURRENT SIZE

1. What is a DAF Anyway?

- A DAF is established when a donor creates a fund through a gift to a DAF charity and a receipt is issued
- Donations can be cash, securities or other investments, insurance proceeds, or bequests, with income generated by the DAF’s capital being gifted to qualified donees
- DAF donors have unique role of making non-binding suggestions regarding asset distribution
- However, compliance with the *Income Tax Act* (ITA) and CRA’s policies is the DAF charity’s sole responsibility
- Imperative that all DAF parties understand how DAFs work, both legally and functionally, in order to avoid unexpected problems or challenges in the future

2. History, Development and Current Size of DAFs

- 1931 & 1952: First DAFs in community foundations
- 1991: Fidelity Charitable Gift Fund established in US
- 2004: Financial services firms in Canada start DAF-holding foundations
- 2006 and 2007: ITA amendments eliminate capital gains tax on donations of publicly traded securities
- 2018: Estimated 15,765 DAFs worth \$5.7 billion CAD, with \$356,000 CAD average fund account size
- Faith-based DAFs grown to \$1.967 billion in 2018
- DAF flow rate (grants) was 85.5% in 2018
- DAFs to continue growing in popularity in Canada: Potential \$7.5 billion (2023) to \$10.3 billion (2026)

3. Who are the Key “Players” in DAFs?

- a) Donors – Attracted to DAFs because of “control”, flexibility and relative anonymity
- b) DAF Charity (“Sponsors”) – Community foundations, in-house foundations of financial institutions, independent DAF charities and single issue focused charities
- c) Registered charities – Recipients of gifts from DAFs
- d) The CRA – Regulator of registered charities
- e) Others - Financial advisors and financial institutions

4. Why are DAFs so Popular Now?

- DAFs may be a practical and appealing alternative for donors who do not have the ability, interest or time to operate their own private family foundations
- Donor is not involved with burden of establishing and managing the DAF, but can still have ongoing advisory role
- Relatively inexpensive to establish a DAF in comparison to a private foundation, so it is accessible to a greater number of potential donors
- DAF donors may enjoy the ability to remain anonymous, given that the DAF charity is interfacing between them and recipient charities of gifts from the DAFs

C. WHAT IS A DAF AT LAW?

1. What is a Charitable Gift?

- A gift is a voluntary transfer of property to another without compensation/consideration
- Donor cannot retain control of gift once it is given to the recipient, with excessive ongoing donor control over gifted property potentially defeating the gift
- This means any donor input over DAF's use or management must be completely non-binding
- The disqualification of a gift may have serious implications under tax law

2. What is a Donor-Restricted Charitable Gift?

- Unrestricted gifts (charity decides how to apply to its charitable purposes) vs. restricted gifts (donor restrictions limit charity's ability to use the gift)
- Special purpose charitable trusts are type of donor-restricted charitable gift, e.g. a charity within a charity, with time restrictions, use restrictions or both
- A charity must identify these restrictions, recognize their legal consequences, and ensure ongoing compliance with them
- Failure to do so may potentially expose the charity and its board to allegations of breach of trust

3. What is a Gift for Income Tax Purposes?

- Donors seeking tax benefits need to ensure donations are gifts at common law and under the ITA
- The CRA has adopted traditional common law definition of a gift, although there are some differences, e.g. split receipting
- Only gifts that meet ITA requirements can be properly receipted by a registered charity
- Improper receipting can potentially lead to CRA sanctions and penalties, revocation of charitable status, designation of ineligible individuals, poor donor relations, and bad press
- If a gift is found to fail, the CRA will reassess the donor's income tax returns that relied on the donation receipt for the invalid gift

4. How Does This All Relate to a DAF?

- DAFs are distinct funds within structure of DAF charities
- Original gift setting up a DAF could be unrestricted or subject to one or more donor restrictions
- Key is donor advised “feature” impressed on the gift at its inception, *i.e.* donor’s ability to offer ongoing “advice”
- This feature is not a donor restriction *per se*
- That said, DAF charity has both practical and moral obligations to follow donor advice, although it alone owns the DAF fund
- From outset, donors must be informed their input is advisory only and the charity makes all DAF decisions
- This is imperative in order that all DAF donations will be true gifts at law and then properly receiptable

D. CURRENT ISSUES ASSOCIATED WITH DAFs

1. Disbursement-Related Issues

- The disbursement quota (“DQ”) is the minimum amount that a registered charity is required to spend each year on its own charitable programs or on gifts to QDs
- Whether 3.5% DQ requirement under the ITA is met determined on an aggregate, not fund-by-fund basis,
- Concern DAF charities “sit on” DAF assets indefinitely
- Some suggest minimum disbursements for each DAF, and selectively imposing different DQ rate on DAFs and/or all restricted charitable funds
- Careful study is necessary as quick action to fix one problem may impact broader charitable sector

- June 2019 Report of the Special Senate Committee on the Charitable Sector (the “Report”) made DQ-related recommendations (#36 and #37) for review by the Advisory Committee on the Charitable Sector
- Federal Budget 2021 then proposed launching public consultations about potential DQ increase in 2022
- Numerous charitable sector representatives have since prepared and filed submissions on the potential DQ increase to the Government
- For more information, see Charity Law Bulletin #498 and the September and October 2021 Church & Charity Law Updates at www.charitylaw.ca
- Charities will need to monitor the progress and outcome of these public consultations

2. Are Some DAFs Really Gifts at Law?

- A more pressing concern is ongoing “control” donors have over DAFs after gifts are made – this is often a key “selling point” but can lead to “disconnect” in how DAFs legally (versus functionally) work
- Too much donor control raises question of whether there is a legal gift and if it is receiptable under the ITA

3. Lack of Transparency and Accountability

- These concerns with DAFs have led to suggestion that DAF charities provide additional information on T3010s: (1) number of DAFs held in the year; and (2) total DAF assets and total distributions to QDs
- Unclear though if this is appropriate or even necessary

E. HOW TO WORK WITH DAFs

1. Need to Properly Establish and Manage DAFs

- Need proper understanding by all parties of what DAFs are at law and how they are to be appropriately administered on day to day basis
- Documents creating a DAF must clearly state that
 - It is the DAF charity which administers the fund
 - DAF charity reserves right to not follow donor advice
- Charity must properly manage its DAFs by ensuring, among other things: (1) compliance with donor restrictions; (2) separate tracking/managing of DAFs; (3) proper investment of each DAF's assets; and (4) no commingling of restricted funds with general funds

2. Practical Advice in Establishing DAFs

- Do your homework! **If** DAFs cannot be established/administered legally, they should not be done at all
- Some key due diligence steps include:
 - develop written gift acceptance policies
 - utilize checklists to ensure consistent treatment
 - ensure good communication with DAF donors
 - prepare appropriate DAF gift agreements
 - know how to manage/administer DAFs correctly in accordance with ITA obligations
- Ensure that the charity, not the donor runs the DAF process, utilizing consistent procedures as set out in policy and applicable gift agreements

- Be vigilant – Charity to be aware of potential issues regarding DAFs and ways to mitigate these risks, e.g.:
 - avoid referring to DAFs as “accounts”
 - avoid referring to donors as “clients”
 - avoid engaging in marketing/communications that suggest a DAF “belongs” to the donor, the donor makes all decisions in relation to the DAF, or the DAF is the donor’s own “private foundation”

F. KEY TAKEAWAYS

- DAFs that are properly set up and operated can be very helpful in facilitating gifts for the charitable sector
- However, both charities and donors should clearly understand the legal requirements of DAFs before getting involved in them
- A DAF that does not comply with all legal requirements may potentially invalidate any gifts made to it, which would then preclude (or later invalidate) any charitable donation receipt issued for these gifts
- DAFs will continue to grow in number and value, so charities and donors, together with their legal counsel, need to be aware of their legal underpinnings and how to operate them properly

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