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# Working With Non-Qualified Donees A PFC/CFC Webinar

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# The Law of Charity

- Common law – the “**what**” of charity
  - doing good is charitable
  - arguing about what is good is not charitable
- The Income Tax Act – the “**how**” of Charity

# Key Concepts

- The key concepts registered charities must know to understand how to work with non-qualified donees are:
  - charitable purposes
  - activities
  - expenditures and gifts (grants)
  - qualified donees

# Legislative provisions

- Definition of “charitable organization” in ITA requires that all resources must be devoted “*to charitable activities carried on by the organization itself*” (149.1(1))
  - source of “own activities” requirement
  - gifts to qualified donees up to 50% of income deemed consistent with “own activities” requirement (para. 149.1(6)(b))
- No parallel requirement for public or private foundations, BUT...
- All charities prohibited from making disbursements by way of gift, other than gifts to QDs or in the course of charitable activities carried on by the charity
- Practical result: all registered charities permitted to spend money in 2 ways:
  - gifts to qualified donees
  - own charitable activities
- Non-compliance can result in revocation, intermediate sanctions

# Purposes or Objects and Activities

- Charity law sees an organization's objects as those ends towards which action is directed.
- Objects are best thought of as collections of possible activities and that are both contemplated by the objects and that aim to advance them.
- But activities cannot stray outside the boundaries of the objects.

# Gifts (Grants) and Expenditures

- **Gift/Grant:** The transference of ownership of a thing or money by one person to another, voluntarily and without any valuable consideration
- **Expenditure:** spending money, the giving of money in return for something

# Grants by Registered Charities

- Canadian registered charities
  - must devote their resources to their own charitable activities, or
  - make grants to qualified donees
- Canadian registered charities may not make grants (gifts) to foreign charities
  - explicit grounds for intermediate sanctions or revocation of registration

# Qualified Donees

- **"qualified donee"** means a donee described in subsection 149.1(1) definition "qualified donee"
- Includes 82,000 registered charities
- + 7 categories of other beneficiaries [see Guidebook]

# Summary



# Contracting with Third Parties

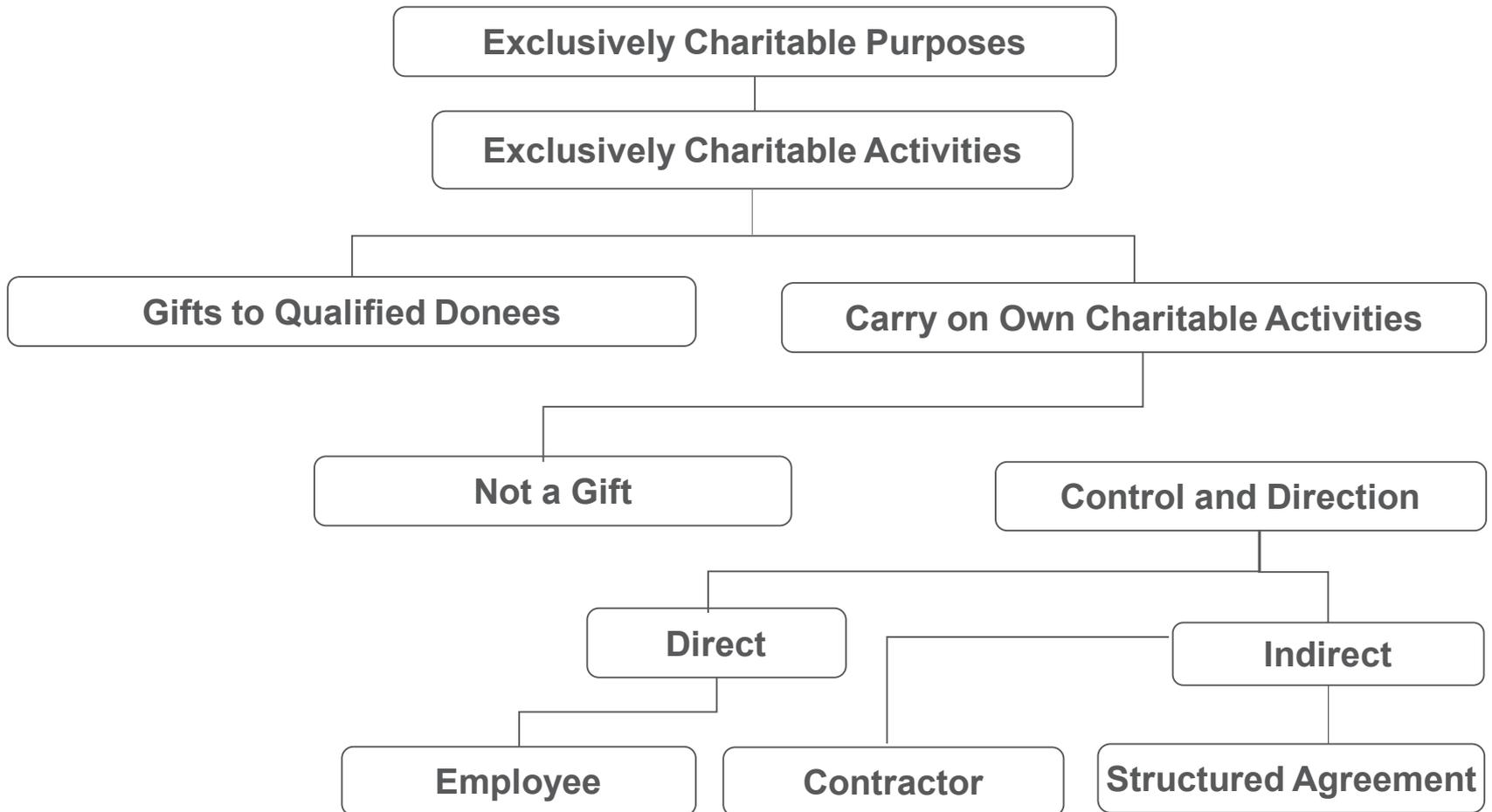
- CRA regularly audits charities working with third parties that are not registered charities
- Canadian registered charities can operate anywhere in the world in two ways – directly or indirectly
  - A. Direct activities
    - local or Canadian employees or volunteers

# Contracting with Third Parties (cont'd)

## B. Indirect Activities through other parties often who are not qualified donees

- Always subject to “own activities” test
  - need binding written agreements
  - agency/joint venture/cooperative partnership arrangements

# Contracting with Third Parties (cont'd)



# Meeting the “Own Activities” Test

- Can meet “own activities” test by working through third party “intermediary”
- CRA imposes two central requirements to meet “own activities” test when working with intermediaries:
  1. need structured arrangement causing the activities of the intermediary to constitute the activities of the charity;
  2. the arrangement must provide for “direction and control” on the part of the Canadian charity.
- Structured arrangements recognized in CRA Guidance CG-002
  - Agency Agreement
  - Joint Venture (pooled funding)
  - Service Contract
  - Co-Operative Partnerships

# Direction and Control

- Appears nowhere in *Income Tax Act* – effectively read into the Act by CRA and upheld by courts
- Various elements set out in CG-002 for demonstrating direction and control
  - Written agreements
  - Initial and ongoing instruction
  - Ongoing monitoring
  - Separation of activities and funds
- Elements of direction and control cumulative in nature
- Must ensure documentation is maintained to demonstrate compliance (para. 230(2)(a)).
- CRA has wide discretion in applying requirements – results in uncertainty

# Written Agreements

- All arrangements with intermediaries should be documented in writing
  - CG-002 sets out elements that CRA will look for in written agreement
- If funds will pass through multiple entities before ultimate expenditure, ensure all entities are bound in agreement structure (e.g., through multi-party agreement; sub-agreements)
- Strive for high standard of compliance, but important that agreement reflect actual practice

# Initial and Ongoing Instruction

- Charity should be able to demonstrate initial instructions in the form of written project description and budget
- Agreement should confirm intermediary is subject to ongoing instructions from charity
  - CG-002 recognizes that charities may accept advice from intermediary and may delegate day-to-day decisions, but must be able to intervene in any decision
- Project planning – can receive proposals from intermediaries, but should be able to show active review, discussion and, in some cases, modification of initial proposal
  - *PTAQ (2015)* – charity selected from “pre-determined package” of programs from agent, with little input or modification; contributed to a finding of lack of direction and control

# Monitoring

- Charity should receive regular reporting on project, including final report
  - Should be both narrative and financial reporting
- Source documentation to verify expenses (receipts, vouchers, invoices)
  - *Promised Land Ministries* (2019) – where receipts unavailable due to cash economy, charity may be able to satisfy source documentation requirement with voucher book signed by individuals and organizations with which charity transacts
- Field visits – staff, volunteers, Board members who visit project sites should provide reports
- Internal documentation (minutes, internal communications, memos, etc) should demonstrate active review and discussion of reports and results

# Separation of Activities

- Critical to distinguish activities of charity from those of the intermediary; applies to both definition of project at outset and reporting from intermediary
  - Challenge where charity wishes to provide funding for portion of total costs of project
  - Option 1: employ structure designed to accommodate pooled funding
  - Option 2: identify discrete portion of total project that can be funded in full by charity; ensure project description and reporting is specific to this component.
- Ensure separate tracking of Canadian funds
  - CRA suggests separate bank account should be used unless “impossible” due to local banking limitations
  - CRA may accept tracking without separate bank account, but other indicators of clear separation become more important

# Criticisms of Current Rules

- Inconsistent with other jurisdictions
  - Other developed countries (e.g., US, UK) have rules providing for transparency and accountability, but not an “own activities” requirement
  - Inconsistency results in confusion, makes collaborations more difficult, less flexible
- Unrealistic expectations around direction and control
  - Particularly where Canadian charity is operating as part of international network
  - Canadian charity often required to take commercially unreasonable positions in negotiations

# Criticisms (cont'd)

- Uncertainty
  - difficult to have certainty as to the compliance “line” in many situations
  - introduces risk, makes negotiations difficult
- Inconsistent with modern development philosophy
  - Direction and control rules are paternalistic, colonial
  - Modern collaborative philosophy emphasizes partnerships and empowering local organizations
- Inefficient and costly

# Possible Reform?

- 2019 report of Senate Special Subcommittee on Charitable Sector acknowledged many of the problems with current rules
- Report included recommendation
  - “That the Government of Canada direct the Canada Revenue Agency to revise Guidance CG-002 “Canadian registered charities carrying out activities outside Canada.” The revised guidance should demonstrate a shift in focus from “direction and control” to careful monitoring through the implementation of an “expenditure responsibility test.”*
- Expenditure responsibility (US concept) requires that private foundations making grants to foreign entities conduct due diligence and maintain certain forms of financial accountability over their grantees.
  - no “own” activities requirement
  - financial accountability rather than operational control

# Advisory Committee on Charitable Sector

- Established in 2019
- Described as a consultative forum for the Government of Canada to engage in meaningful dialogue with the charitable sector, to advance emerging issues relating to charities, and to ensure the regulatory environment supports the important work that charities do.
- Report of Senate Special Subcommittee urged Government and Advisory Committee to take up recommendations

# Thank-you

- Susan and Troy want to make a shout out to their partner Andrew Valentine who had put together much of this slide deck for another presentation earlier this year
- Thanks Andrew!

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