Q&A from CRA about Grants to Grantees under the Qualifying Disbursement Rules

By Mark Blumberg (September 26, 2024)

On December 19, 2023 CRA published their Guidance CG-032, Registered charities making grants to non-qualified donees.

The new guidance is helpful, but because of the complexity of the wording from the Income Tax Act (Canada) and the lack of case law, there are lots of questions about how the rules will be interpreted.

Unlike the direction and control rules that have multiple court cases and decades of refined CRA guidance, there is very little relating to the grant to grantee rules. We also find that if we have a charity application or change to purposes requests, using these new rules can add 3-6 months to the amount of time it takes to receive a response over and above when a similar fact pattern is provided to CRA dealing with direction and control.

In January 2024, we wrote to CRA with various questions relating to the new grant to grantee rules.

In September 2024 CRA provided some responses to these questions. Some of the responses are more clear and helpful than others. Keep in mind that, ultimately, all the facts and circumstances will make a difference.

We are generally suggesting that Canadian charities to avoid using these new grant-to-grantee rules unless absolutely necessary. We have blogged extensively about this topic before.

Here is the CRA response to our various questions:

> Thank you for your questions and hypothetical scenarios. We appreciate your patience as we developed this response.

Please note that the application of the directed giving rules is fact specific – it depends on the detailed facts and circumstances of each case, so the CRA is not able to provide a conclusive analysis to the hypotheticals you provided. However, we can provide some general considerations, as outlined below.

Scenario 1

Let's suppose that a Canadian charity has an education and research object dealing with racism and we are approached by a new incorporated non-qualified donee that does work in the anti-racism space in Canada. The non-qualified donee is asking the Canadian charity for funding for capacity building and specifically to hire a new Executive Director by making a qualifying disbursement using grant to grantee. Can the Canadian charity make a qualifying disbursement for that particular purpose?

Response to scenario 1:

Generally speaking, it is possible for a charity to make a qualifying disbursement to a non-qualified donee to go towards paying all or part of the salary of a grantee's employee, such as an Executive Director. The grant would have to meet all requirements of the Income Tax Act and common law, including the accountability requirements outlined in Guidance CG-032, Registered charities making grants to non-qualified donees.

Here are some questions for further consideration:

- What is the charitable activity that this grant is being exclusively applied to?
    - A charitable activity is one that furthers a charitable purpose.
    - This includes incidental charitable activities that are undertaken to accomplish its charitable purpose – that is, an activity that supports, facilitates, or contributes to a charity's ability to provide charitable benefits, such as fundraising or management and administration activities. However, an incidental charitable activity cannot further a non-charitable purpose, and cannot become a purpose in and of itself.
    - Generally speaking, the CRA takes the view that a charity can make grants towards incidental charitable activities; however, all ITA requirements for grants must still be met.

- What are the Executive Director's (ED) tasks and responsibilities? How does the ED's proposed work and tasks relate to the charitable activities and the charity's charitable purposes? Do they support, facilitate, or contribute to the grantee's ability to carry on the charitable activities?
    - If all of the grantee's activities further the charity's charitable purposes, then this might be acceptable. However, where the grantee also carries on other types of activities that are not charitable or do not relate to the charity's purposes, then funding the ED's full salary cannot be shown to be used exclusively on charitable activities that further the charity's charitable purpose.
    - Funding part of the ED's salary may be acceptable, if the charity and grantee can show that the portion of the ED's salary that was granted was applied only to charitable activities that further the charity's charitable purposes.
- As with all grants, the charity would need to determine whether the grant is providing a public benefit, and ensure the grant is not providing any unacceptable private benefit. For example, is the ED's salary within the range of fair market value?

Scenario 2

A Canadian foundation receives a proposal for a project from a non-qualified donee in a foreign country (and has discussions with the non-qualified donee about the project). The Foundation receives approval from the board of directors of the Foundation to move forward with that particular project. The Foundation does not directly fund the non-qualified donee using direction and control or grant to grantee, but the Foundation makes a gift to a qualified donee (QD) in Canada for that particular project (such QD to have some form of relationship with the non-qualified donee).

The Foundation enters into a gift agreement with the QD for that particular project, with provisions that:

- the QD has the ultimate authority to use the funds as it wishes,
- the Foundation cannot have the funds returned if the QD uses them for something else
- the QD covenants to exercise direction and control if working with a non-QD on the particular project

Is this appropriate for the Canadian foundation? Is this appropriate for the Recipient charity?

Response to scenario 2:

- Paragraph 168(1)(f) of the Income Tax Act, which prohibits directed giving, references the recipient charity who "accepts" the gift. However, a gifting body (such as another charity) should not make a gift that a charity cannot accept.

- The CRA takes the position that this provision does not apply to a charity's own activities, including when it exercises direction and control over an intermediary.
- The CRA is therefore unlikely to consider the proposed transaction to be directed giving under 168(1)(f).
- However, to avoid concerns around directed giving, and since the recipient charity may require more flexibility (for example, undertaking certain programing through an intermediary relationship, and other activities through grants to the non-qualified donee), we suggest the gifting Foundation should indicate a *program preference*, rather than specifying a non-qualified donee.

Scenario 3

This question deals with Foundations and administrative expenses. The Foundation has a QD clause and other charitable objects. It has to do with allocating expenses to the programs for DQ purposes. The Foundation makes gifts to qualified donees and also does direction and control and grant to grantees. When a lawyer works on a gift agreement, grant agreement or intermediary agreement is that admin or charitable?

Response to scenario 3:

- As per Scenario 1, a charity could make a grant for incidental charitable activities, such as management and administration, that are undertaken to accomplish a charity's charitable purposes. When a lawyer works on a gift agreement, grant agreement, or intermediary agreement, this could be considered as an expense for incidental charitable activities.
- While a charity and its grantee can engage in administration and management expenses that could be considered incidental charitable activities, this classification is separate from the charity's reporting obligations under the Income Tax Act on the disbursement quota and granting to grantees.
    - For a charity's own activities (including intermediaries), the Form T3010, Registered Charity Information Return (the T3010) reporting rules separate administration and management fees from the charity's charitable activities. Although administration and management may be considered incidental charitable activities for the purposes of meeting a charity's definitional requirements in 149.1(1), they would have to be reported on the T3010 as administration and management expenditures on line 5010.
    - However, the grant to grantee reporting questions do not separate administration and management fees from the grant.
    - Determining if administration and management expenses should be reported as administration and management as part of a charity's own activity, or as part of the grant activity, is a question of fact.
        - Generally speaking, if the charity is incurring the administration and management expenses as part of its own activities, for example, by

paying legal fees to set up different types of agreements, including granting, these should be reported as the charity's administration and management expenses.

- However, when the charity grants funds to a grantee, any part of such grant used by the grantee for administration and management expenses should be reported by the charity in the portion of the T3010 as a grant to a grantee on the appropriate lines and Form T1441, Qualifying Disbursements: Grants to Non-Qualified Donees (Grantees).

Scenario 4

A foundation has an object but the area of work that they want to conduct an activity in while charitable is outside their object. If they have a potential program with a non-qualified donee and it is outside the object but still charitable does it matter to CRA from an enforcement perspective whether it is a grant to grantee or direction and control in terms of it being outside of their object?

If one asks CRA to review an object it takes about 4-6 months. Typically, we suggest groups ask CRA for permission to change objects, then CRA provides the approval and then the changes are made. Should groups considering grant to grantees or direction and control make the changes and then immediately request CRA approval?

Response to scenario 4:

- We recommend charities contact us before amending their purposes, to ensure they meet the requirements of the law.
- The CRA is working to respond to the requests to change purposes as quickly as possible.

Scenario 5

Section 76 deals with directed gifts.

"76. Here is an example of an explicitly conditional gift:

A donor indicates that a gift must be used to grant money to a specific non-qualified donee, and if it is not used for that purpose, the funds must be returned to the donor. This could constitute a legally binding conditional gift, and if the charity accepted it, this could jeopardize its registration."

Is it ever acceptable for a Canadian charity or a donor to give funds to a QD and specify those funds need go to a NQD provided it is clear that no funds will be returned to the charity or donor?

Does it matter if a receipt is issued or not? If given as conditional gift by donor and no receipt yet issued can funds be returned?

If a sponsorship by a corporation and receipt given by Canadian charity – but want funds to go to a non-qualified donee in a foreign country?

Response to scenario 5:

- Paragraph 168(1)(f) of the Income Tax Act applies to the recipient charity who "accepts" the gift.
- Since directed giving is fact specific, not issuing a receipt could potentially be interpreted as one possible indicator that the charity has not accepted the gift; however, returning gifts is complex and not encouraged by the CRA as a practice. There are considerations that apply, outside of the scope of the CRA. And as a general rule, a registered charity cannot return a gift (see Qualified donees – Consequences of returning donated property). Instead, a charity should not accept gifts where the donor makes the gift conditional on it being granted (or "gifted") over to a specified grantee (as opposed to specifying a *program preference*), as this could put the recipient charity in a situation where it could contravene the Income Tax Act.
- These same considerations apply for a sponsorship by a corporation, and funds to a grantee in a foreign country.

Scenario 6

Many groups have names that are similar to affiliated groups in Canada or elsewhere that are non-qualified donees. In paragraph 77 of the Guidance, it notes:

77. Here is an example of an implicitly conditional gift:

A charity includes the name of a non-qualified donee in its own name, purposes, or other formal documents, indicating this would be the sole recipient of any grants the charity makes. Any funds the charity receives from a donor could be implicitly conditional on the charity granting it over to the specified non-qualified donee, and could jeopardize the charity's registration.

If the charity is not "indicating this would be the sole recipient of any grants the charity makes" then is it still implicit just because of the name even though the group may work with other non-qualified donees or qualified donees? In other words, is it the name or the statement about sole recipient that makes this inappropriate. Should groups change their names?

Response to scenario 6:

- The Explanatory Notes from the Minister of Finance specify that paragraph 168(1)(f) is intended to prevent organizations from acting as conduits in the making of a directed gift.
    - This prevents situations such as where a charity, with donor knowledge, solely exists as a fundraising arm of an affiliate organization. In these circumstances, the charity would not be in a position to make decisions around the use of its resources, or act independently of the affiliate.
    - Therefore, a charity could not be established to solely make grants to one specified grantee.
    - By contrast, a charity could be established to make gifts to a specified qualified donee, or carry on the charity's own activities by exercising direction and control over a specified intermediary.
- The charity's name is one possible indicator – but it is not the only indicator – that the charity may be engaged in directed giving.
- For affiliate or "friends of" charities that wish to make grants to grantees, they must first ensure this is authorized by their purposes. If it is not, they may need to change their purposes.
- As with all charities, a charity that shares the same name as a non-qualified donee should ensure it *communicates* to its donors that it is holding authority over the use of its resources, and *must also* be able to *show* that it can and does hold authority over the use of its resources.
    - This means showing that the charity holds authority both in terms of how it applies donors' gifts [directed giving restrictions in paragraph 168(1)(f)], as well

as how its resources are applied by grantees [requirements for grants to grantees in subsection 149.1(1)].

- In order to *show* that charities can and do in fact hold authority over the use of their resources, affiliated charities could consider diversifying their activities, programs, and funding recipients. For example, the charity could then be in a position to choose to apply a donor's gift by way of a grant to a grantee, gift to qualified donee, carry out its own activities, or work through an intermediary by exercising direction and control.

Scenario 7

If a charity received 10m in 2021 then we assume that the directed donation rule does not apply to it. But will CRA look back retroactively to see if implicit or explicit commitments were made?

Response to scenario 7:

- It is not indicated in the Income Tax Act or Bill C-19, Budget Implementation Act, 2022, No 1, that paragraph 168(1)(f) is to be applied retroactively.
- However, its present application could apply to gifts that were not yet "accepted" by the charity prior to June 23, 2022, and have since been accepted. This application would be a question of fact.

Scenario 8

A DAF has various funds. Normally funds are recommended to qualified donees. Can a donor or donor advisor recommend that the funds go to a NQD rather than a qualified donee?

Response to scenario 8:

- Generally speaking, a donor advised fund (DAF) typically involves a donor indicating its *preference* for how an irrevocable gift it makes to a registered charity is used. The donor's preference is not binding on the charity.

- Similarly, a donor could indicate its *program preference* (as opposed to specifying the name of a non-qualified donee) for a DAF to go to a grant program.
- However, the charity that received the DAF to make the grant to a grant program is ultimately responsible for meeting all of the requirements of the Income Tax Act, including meeting the accountability requirements for a grant to a grantee, as well as ensuring it does not engage in directed giving when it accepts a gift.

Scenario 9

The CRA Guidance provides in paragraph 80 and 81 as follows:

> 80. Provided a charity can show it retains authority over the use of its resources, we will consider the charity to not be engaged in directed giving.
>
> 81. Alternatively, a charity could use the donation to carry on its own activities through an intermediary, provided the charity exercises direction and control over the use of its resources.

We are interpreting paragraph 81 to mean that if direction and control is used (let us assume that it is done correctly) then the directed donation rule does not apply. Is that correct?

Response to scenario 9:

- Yes. The CRA takes the position that a charity carrying on its own activities by exercising direction and control is not engaging in directed giving because it is the charity's own activities, as opposed to a "gift" (or "grant") to a non-qualified donee.

Hopefully, these CRA responses will be helpful to Canadian charities trying to understand these new rules.

Mark Blumberg is a lawyer at Blumbergs Professional Corporation in Toronto, Ontario. He can be contacted at mark@blumbergs.ca or at 416-361-1982 or Toll-Free: 1-866-961-1982 or at contact us. To find out more about legal services that Blumbergs provides to Canadian charities and non-profits as well as foreign charities, please visit www.CanadianCharityLaw.ca, www.SmartGiving.ca,or www.CharityData.ca