



April 2022

Important Changes for Charities Arising from the 2022 Federal Budget

By Linda J. Godel and Lauren Crosby

The 2022 Federal Budget (**Budget 2022**), which was released on April 7, 2022, contains some significant changes directed at charities. Of key importance to the broader charitable sector are two specific proposed measures - the first, providing greater flexibility for registered charities to work with non-charities; and the second, implementing changes to registered charities' disbursement quotas.

Greater Flexibility for Canadian Registered Charities to Work with Others

Canadian registered charities operating in Canada or abroad have historically been subject to stricter compliance regimes than charities in other jurisdictions. In particular, under the *Income Tax Act* (Canada) (**ITA**), Canadian registered charities can only carry on their "own charitable activities" or make gifts to qualified donees (that is, Canadian registered charities and certain other organizations that can issue Canadian tax donation receipts) (**QDs**).

As a result of these limitations, Canadian charities have been unable to simply give resources to non-QDs, including foreign charities or non-profit organizations based in or outside of Canada, even if they do good work for the benefit of the public. Rather, a Canadian charity needs to ensure that any resources it provides to non-QDs are used to support the Canadian charity's "own activities" (which is a confusing concept), and that any activities that are carried out by the non-QDs on the Canadian charity's behalf are continuously directed and controlled by the Canadian charity in accordance with the complex and onerous requirements contained in the policies of the Canada Revenue Agency (**CRA**).

For example, a Canadian charity wishing to support Ukrainian relief efforts cannot send funds to a non-governmental organization (**NGO**) in the Ukraine, but rather may enter into an arrangement with the NGO for it to provide relief efforts on behalf of the Canadian charity. Any such arrangement must make it clear that the funds provided by the Canadian charity are being used by the NGO to carry out the Canadian charity's own activities, and that the Canadian charity maintains direction and control over such activities in accordance with Canadian charity law. Given the crisis situation, the Ukrainian NGO may not have the

time or resources to spend negotiating an arrangement with the Canadian charity, or attempting to discern and meet the onerous Canadian legal requirements.

In practice, these extensive and burdensome obligations impose significant administrative expenses on Canadian charities and the non-QDs with whom they work, and can hinder the ability for Canadian charities to carry out certain activities that they do not have the capacity or expertise to do on their own, particularly in times of emergency. In many cases, the Canadian-specific requirements prevent these relationships from moving forward.

In November 2021, Senator Ratna Omidvar introduced Bill S-216, *The Effective and Accountable Charities Act (Bill S-216)*, into the Senate, which proposes amendments to the own activities requirements for charities contained in the ITA. Bill S-216 passed through the Senate on December 9, 2021, and completed first reading in the House of Commons on February 3, 2022. The key amendment to the ITA contained in Bill S-216 provides that the making of resources available to a non-QD is a charitable activity if a Canadian charity “takes reasonable steps to ensure that those resources are used exclusively for a charitable purpose.” The charitable sector has strongly supported the passing of Bill S-216 into law, as it will provide much needed flexibility for the sector.

Budget 2022 addresses the rigidity of the “own activities” restriction by proposing to “implement the spirit of Bill S-216” by amending the ITA to permit charities to make “qualifying disbursements” to non-QDs to further a charity’s charitable purposes. Charities will be required to ensure that any such disbursements are, in fact, used for charitable activities, and must also satisfy certain accountability requirements (many of which are current CRA recommendations), including entering into a written agreement with each recipient, undertaking due diligence on recipients to assess the likelihood that they will comply with the requirements of an agreement, and monitoring the use of disbursements by recipients. Qualifying disbursements of a charity in excess of \$5,000 will also need to be reported on the annual T3010, Registered Charity Information Return, (T3010), and such information will be available to the public.

In addition, Budget 2022 proposes additional mandated recordkeeping requirements for qualifying disbursements to non-QDs, and adds a new restriction to the ITA that would explicitly prohibit Canadian registered charities from acting as a conduit, that is, by accepting a donation that is specifically directed to be paid to a non-QD.

The ability for Canadian registered charities to provide funding to non-QDs is certainly a welcome change and appears to provide more flexibility. Unfortunately, the complexity and administrative burden of the new proposed measures with respect to working with non-QDs, both in and outside of Canada, appears to largely reflect how the current framework is implemented by the CRA but with added requirements.

Changes to the Disbursement Quota

Under the ITA, Canadian registered charities are required to spend a minimum amount each year on their own charitable activities or by making gifts to QDs (over and above the amount they spend on their administration and management, or fundraising expenses).

This spending requirement, called the disbursement quota (**DQ**), is basically equal to 3.5% of a charity’s assets which are not used directly in furtherance of its own activities, funding QDs or on its own administration (**invested assets**). The DQ ensures that charities apply their funds for charitable purposes and contribute to the community at large, rather than merely accumulating wealth. However, there has been speculation that not enough charitable funds are being expended, particularly from donor advised funds (**DAFs**) and by certain charitable foundations.

As a result, and as we reported in our article on the 2021 Federal Budget, public consultations with charities were launched to consider the DQ and whether an increase was warranted. Apparently, the answer was yes since Budget 2022 proposes to increase the DQ for certain charities. More specifically, charities with invested assets of more than \$1M that were not used directly in furtherance of their own activities, funding QDs, or on their own administration will be required to spend 5% of these invested assets, rather than 3.5%, which will still be the rate applicable to charities with invested assets of \$1M or less. This change to the DQ will come into effect for charities with respect to financial year ends beginning on or after January 1, 2023.

Situations have arisen in the past with charities not being able to meet their DQs. To address this issue, the ITA currently allows the CRA, upon application by a charity, to deem that a certain lesser amount spent by the charity in a taxation year satisfied its DQ. CRA policy sets out various requirements for granting such applications, including that a charity must first apply any DQ excesses from its preceding five years and demonstrate that it will not be able to make up the shortfall in the subsequent year before the CRA will grant relief. Budget 2022 proposes to change this current deeming rule to enable the CRA to lower a charity's DQ requirement for a specific tax year, and where a charity's request for a reduction to its DQ is approved, the CRA will be entitled to publicly disclose information relating to its decision to do so. The rationale for the change as articulated in Budget 2022 is to "better reflect actual expenditures on charitable activities."

Another DQ-related change announced in Budget 2022 is that the CRA will be making enhancements to the information that it collects from charities regarding DQ compliance, as well as their DAFs and investments. Additional data will presumably be required to be included in the T3010 that each charity must file within six months of its year end.

These changes to the DQ amount and charities' reporting obligations could have a material impact on charities with significant DAFs and investments. Charities will need to review their DAF agreements and their investment policies to ensure they provide sufficient flexibility to meet the increased DQ requirement, and may wish to consider the applicability of the new rules for the reduction of their DQs.

As further details become available, we will gain greater clarity about the impact of the proposals applicable to Canadian registered charities in Budget 2022. In the meantime, a member of our Not-for-Profit & Charities Group would be happy to advise on any changes in law and policy that may affect your organization.

Authors



Linda J. Godel
Partner

Tel: 416 643 8809
lgodel@torkinmanes.com



Lauren Crosby
Associate

Tel: 416 777 5429
lcrosby@torkinmanes.com

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