

KEY POINTS

What is the issue?

Charities are regulated in part by the legislation of the jurisdiction in which they are formed, with either prescriptive or principles-based rules.

What does it mean for me?

Philanthropists want to know that the charities they support serve the public benefit, regardless of how the applicable rules for charities are described.

What can I take away?

In Canada, as an example, new principles may make it easier for charities to operate across borders and government guidance will likely add a layer of additional rules to the new principles, so one should focus on the substance of the resulting rules rather than on the prescriptive or principles-based distinction.



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DANIEL FRAJMAN LOOKS AT CURRENT CHANGES TO RULES AND PRINCIPLES IN CANADIAN CHARITY LAW, INCLUDING FOR INTERNATIONAL GIVING

Philanthropists are, rightly, always preoccupied with assuring that there is adequate oversight over the use of charitable gifts, often through government regulation of the purposes and activities of charities. This is to assure, for example, that charitable funds are indeed used for acceptable public benefit. Various jurisdictions will have either prescriptive (rules-based, purportedly promoting certainty) governmental regulation of their charities or a more principles-based approach to regulation (relying more on general principles, purportedly promoting flexibility). Arguably, both approaches often end up with similar rules (although, more statutory when prescriptive and more based on government guidance when principles-based), so the focus should be on determining whether the ultimate rules are adequate, rather than on determining whether an appellation such as prescriptive or principles-based applies.

The recent and ongoing Canadian experience in reviewing its charity oversight rules is an example of this, and will be explored further below.

It is worth first recalling that the UK regulation of charities is often said to be principles-based (a reasonableness test

for proper application of funds granted abroad, for example) for use of charitable funds, whereas the US is known to be more prescriptive (with expenditure responsibility and equivalency standards).¹ Nevertheless, and as suggested above, the prescriptive/principles dichotomy will often get blurred in those jurisdictions. For example, US expenditure responsibility has some general requirements along with a list of impermissible activities.

THE CANADIAN EXPERIENCE

This brings us to the recent Canadian experience. Long-standing rules in s.149.1(1) of Canada's *Income Tax Act* state, as what can be characterised as a principle, that all charitable activities be 'carried out by the organization itself'. This requirement is referred to as the 'own activities' test. However, this test has been fleshed out by the Canada Revenue Agency (the CRA) in published guidance that requires the Canadian charity to have 'direction and control' over the use of its resources when, for example, working with a consultant, contractor or joint venture partner so as to carry out charitable activity.²

This direction and control (principles-based but almost prescriptive given the government guidance) has been criticised by many as promoting too much oversight and also as being artificial



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use of CRA guidance) and also adds an alternate new tool.

NEW TOOL

Known as the ‘qualifying disbursement’ rules, the new tool is designed to allow Canadian charities to make disbursements to non-charities (i.e., organisations that are not registered in Canada as charities, or ‘grantee organizations’)⁵ without direction and control. However, the Canadian charity would have to assure that the gift or resources provided are used for the charitable purpose and activity of the Canadian charity and maintain extensive documentation to back this up. Certain mandatory accounting rules included in early 2022 in the first version of this government legislation were dropped in the passed legislation due to complaints that those rules were too prescriptive. Significantly, however, many advisors feel that the new qualifying disbursement rules cannot be used yet, as the CRA is likely to release further guidance as to how these new rules are actually to be implemented.

Other common themes of charity regulation that navigate the prescriptive and principles-based distinction have also recently come up in Canada. For example, concerning annual minimum spending requirements of charities,⁶ a 2022 Canadian government budget announcement changed the spending percentage to 5 per cent for years beginning in 2023 but only for property not used in charitable activities or administration that exceeds CAD1 million in value (the pre-existing 3.5 per cent percentage is maintained for such property up to and including CAD1 million in value). The principle here seems to be that many charities were thought to be unduly stockpiling assets and not employing them for beneficiaries. Although the new rule avoids, for example, delving into regulating

use of donor-advised funds (which might have been seen as overly prescriptive), those crunching the numbers to apply the new disbursement quota percentage will feel the regulatory change.

Another addition to Canada’s regulatory landscape is the ‘anti-directed giving rule’.⁷ This rule essentially states that a charity cannot accept a gift that the donor has conditioned expressly or implicitly be used to make a disbursement to a non-charity. Many advisors are reticent to provide advice on this new rule, pending anticipated government guidance on how it will work. For example, some have pointed to possible unofficial government assurances that this new rule is meant to address concerns around terrorism and is not meant to prohibit contributions to international pooled funds.⁸ However, it will likely be upcoming government guidance that will dictate whether flexibility is available for this rule.

As a result, Canada has essentially gone full circle in dealing with the prescriptive/principles dichotomy for rules in the charitable sector by, for example, maintaining the direction and control rule (said to be principles-based but subject to prescriptive-like details in government guidance) and adding a new qualifying disbursement rule (also seemingly principles-based but likely subject to upcoming government guidance).

CONCLUSION

What can we take from this? One should look to the substance of charity regulation and, in doing so, one will likely find a body of detailed rules in many jurisdictions aimed at supporting public benefit and overseeing the proper use of charitable gifts. In this regard, one should not put undue focus on the principles/prescriptive terminology, which can be confusing because the two concepts often lead to a similar result. Hopefully, philanthropists can take comfort in the application of these rules.

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(due to it being difficult to have outright control over activities that a charity carries out in another jurisdiction, for example). On the other hand, others have supported direction and control as, for example, favouring concentration on smaller projects that support the smaller non-governmental organisation beneficiaries that often have the most need. It can be argued that the direction and control approach offers flexibility and encourages local input as, for example, the CRA guidance leaves room for significant programme suggestion and a day-to-day operational role for the beneficiaries on the ground.

This significant, but not unanimous, criticism in Canada of direction and control has recently come to a head. About three years after a Canadian senate report, *Catalyst for Change: A roadmap to a stronger charitable sector*, came out in favour of shifting focus from direction and control to an expenditure responsibility test, and about two years after a non-governmental Bill was introduced in the Canadian Parliament by Senator Ratna Omidvar to bulk out the earlier report,³ the Canadian government stepped in and passed legislation that replaced Omidvar’s Bill and deals with matters in a different way. The government legislation that is now in force⁴ maintains direction and control as a tool that can be used by Canadian charities (allowing continued

1 D Frajman TEP and A Petraske, ‘Philanthropy Abroad’, *STEP Journal*, Vol28 Iss4, p19 2 For example, ‘CRA guidance CG-002, Canadian registered charities carrying on activities outside Canada’ (8 July 2010, revised 27 November 2020). 3 By proposing that direction and control be replaced by a reasonableness test, in that resources could be made available by a charity taking reasonable steps to ensure that the resources are used exclusively for charitable purposes. 4 *Federal Bill C-19* 5 ‘Qualifying disbursement’ and ‘grantee organization’ at newly amended s.149.1(1) of the *Income Tax Act* (the Act). 6 In essence, 3.5 per cent of a Canadian charity’s property not used directly in charitable activities or administration during the previous two years is a disbursement quota that must be used in its charitable activity in the ensuing year. 7 Newly amended para.168(1)(f) of the Act. 8 Tim Harper, ‘For Canadian Charities, Victory on Budget Implementation Act is Tempered by Uncertainty’, *The Philanthropist Journal* (8 June 2022)