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Wills, Trusts & Estates

Bill S-222: Eliminating the 'own activities' requirement for charities

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(March 16, 2021, 2:08 PM EDT) -- A new bill introduced into the Senate last month may give Canadian charities much needed legislative reform. Ratna Omidvar, senator for Ontario, tabled Bill S-222, the *Effective and Accountable Charities Act* (the bill) for first reading on Feb. 8, 2021. The bill proposes significant changes to provisions of the *Income Tax Act* (ITA) governing how charities in Canada can work with other organizations that are not registered charities — or not otherwise "qualified donees" (which are organizations that can issue official donation receipts). This article offers a brief background of the need for legislative reform and what the new bill proposes to change.

The ITA currently contains unnecessary and archaic provisions that have been in place since the 1950s, requiring charities to devote all of their resources to charitable activities carried on by the organization itself. This is known in the charitable sector as the "own activities test." This has led the Canada Revenue Agency (CRA) to implement an administrative policy that charities must direct and control the use of their resources when working through an intermediary, known as the "direction and control" requirement. Such a requirement severely limits how charities can work with third parties that are not qualified donees.

Many in the sector have consistently expressed concerns with the CRA's interpretation of the own activities test and the direction and control mechanism for years. Although the CRA updated its guidance on Nov. 27, 2020, by relaxing some of its more onerous requirements, there were no substantive changes to the CRA's direction and control policy. The bill proposes to replace the own activities requirement with a practical approach of resource accountability rather than the current restrictive regime of direction and control.

Omidvar's introduction of the bill coincides with a new report from the CRA's Advisory Committee on the Charitable Sector — dated January 2021 but published March 12 on the CRA website. The proposed changes to the bill are consistent with the new report's recommendation to remove the own activities test.

Problems with the status quo

The requirement that all the resources of a charitable organization be devoted to charitable activities carried on by the organization itself has remained the same since 1950, despite various amendments to the ITA over the years. The legislative regime at the time intended to prevent charitable organizations from endlessly circulating or sheltering funds without actually using them for charitable relief. However, it is highly doubtful whether the legal rationale of 1950 is still relevant in 2021. The following are some of the key difficulties with the own activities test and the CRA's corresponding direction and control mechanism.

- **Creates a legal fiction**: requiring programs to be the "own activities" of the funding charity creates a legal fiction. This mechanism is outmoded, impractical, inefficient, inordinately expensive, unpopular and fails to meet the objectives of the ITA. It is built upon the fiction that everything that a charity does through a third-party intermediary must be structured as the activity of the charity itself when all parties know that the activity is that of a third party. As a result, the direction and control regime has created a fictitious counter-reality that charities have extreme difficulty in complying with and which causes charities to become exposed to unnecessary liability.
- **Internationally outdated**: requiring a top-down approach to dictate how charitable activities are carried out is at odds with current international development philosophy that recognizes the importance of empowering partnerships with local communities and non-governmental organizations.
- **Impractical and unrealistic**: the micromanagement required of charities, including monitoring and reporting rules, distracts charities from focusing on their programs and ignores the benefit of a potential partner organization's local expertise in an international context.
- **High administrative costs**: complying with the CRA's onerous requirements draws scarce resources away from charitable work, even where the charity has no concerns with a trusted foreign partner, resulting in a poor expenditure of resources or preventing smaller charities from engaging in foreign activities.
- **Obstructs Indigenous communities**: the CRA's direction and control requirements impose a paternalistic and patronizing relationship between charitable organizations and Indigenous communities that are not registered charities or other types of qualified donees.

Proposed changes

The bill's most important proposed change is the removal of the own activities test by amending the ITA to require charities to carry on "charitable activities" instead of "charitable activities carried on by it." This is done by amending sections 149.1, 188, 188.1 and 189 of the ITA in relation to the definition of "charitable organizations" and the meaning of "non-qualified investments"; revocation of charitable organizations, public foundations, and private foundations; how charities may devote their resources for charitable activities; as well as the calculation of the disbursement quota and revocation tax.

With the "own activities" test removed, the bill proposes to allow charities to make their resources available to non-qualified donees, provided that the charity takes "reasonable steps" to ensure that those resources are used exclusively for a charitable purpose. This is done by expanding the definition of "charitable activities" in ss. 149.1(1) of the ITA. A new ss. 149.1(27) would be added to prescribe what exactly constitutes "reasonable steps" to ensure the exclusive use of resources for a charitable purpose, including obtaining appropriate due diligence information of the third party and imposing necessary restrictions and conditions on the transfer of resources.

These important amendments would lift an unnecessary burden from Canadian charities, hampered as they are by historical concerns that are no longer justified and out of order with international legal progress. While Omidvar's introduction of the bill is a welcome and encouraging development for the charitable sector in Canada, it is still in its early stages of review, and charities will therefore want to support as well as monitor the status of the bill as it makes its way through Parliament.

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