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Making It Easier to Do Good: Doing Away with the "Own Activities" Requirement

Legal advisors that work regularly with Canadian registered charities have long criticised aspects of the regulatory regime that applies to these organizations. This commentary has been written to summarize a key concern with these rules, and to urge legislative and regulatory reform to better facilitate the work of the charitable sector in Canada.

Canadian registered charities play a vital role in providing support to those in need in our communities. This has never been more true than during the COVID-19 pandemic, which has increased demand immensely for the services and programs that charities deliver. The pandemic crisis, and the urgent need for charities to be able to deploy their resources quickly and effectively, has provided a striking reminder of the importance of a regulatory system that enables charities to operate as efficiently as possible and that does not impose needless obstacles.

Unfortunately, charities in Canada have been hamstrung for too long by legal rules that are cumbersome and inefficient. The key barrier is the so-called "own activities" requirement under the *Income Tax Act*. This rule requires that when registered charities work with other organizations that are not themselves Canadian registered charities or do not fall within certain narrow categories (referred to as "non-qualified donees"), charities must structure the relationship with the third party so that work pursued by the third party will be legally considered a devotion of resources to charitable activities carried on *by the Canadian charity* (to use the jargon in the *Income Tax Act*).

In addition to the above structuring requirement, the Canada Revenue Agency also requires that the charity must exercise "direction and control" over any resources provided to the third party, and has set out extremely detailed guidance on the elements of direction and control that must be present. This requires charities to enter into complex arrangements with project partners, and imposes detailed requirements for continued monitoring, oversight, and direction of the activities which are carried out by a third party organization.

It is undeniably appropriate that Canadian registered charities –- which enjoy special privileges under the *Income Tax Act* and can receive tax subsidized donations from the public –- should be required to take steps to ensure that their funds are used for charitable purposes. Canadians should know that when they support a registered charity, their funds will be used for their intended purpose, and charities should be subject to appropriate regulatory accountability.

However, the "own activities" requirement –- as it has been interpreted by the courts and by CRA –- imposes artificial constraints on charities' ability to work with third parties that do nothing to further this legitimate objective. The complexity of the rules results in high administrative costs that could instead be spent on charitable work, and in some cases prevents the delivery of charitable programs altogether. Furthermore, the emphasis on "top down", paternalistic direction and control by Canadian charities perpetuates a colonial approach to work in the developing world and with Indigenous communities that is inconsistent with modern development philosophy and prevents the formation of equal, empowered partnerships.

Form over Substance

A key problem with the own activities requirement is that it prioritizes form over substance. Registered charities work in a wide range of sectors –- poverty relief, health, education, international development, to name a few –- and need the ability to innovate so as to meet the ever-changing needs in these different areas. This requires flexibility in the manner in which

they work with third parties. Effective collaboration with other organizations is indispensable in enabling charities to ensure that their funds do the most good as efficiently as possible. A well-designed regulatory regime would recognize this, and would give charities flexibility to structure their relationships with third parties as the circumstances require.

The "own activities" requirement, however, does not allow this. It forces charities, when structuring relationships with third parties, to turn themselves to the abstract and artificial question of "whose activities" are being carried out? Is it the charity's activity or the third party's? This means, for example, that a charity cannot make a grant to a non-qualified donee for a charitable project, regardless of how many safeguards and conditions it attaches to the grant to ensure transparency and accountability for the expenditure of those funds. Notwithstanding that grant funding is a standard mechanism for development work in nearly all other countries, CRA does not consider a grant to meet the "own activities" requirement. Pooled funding arrangements are also exceedingly difficult. It is common in the charitable world for multiple organizations to pool funds for a common charitable project, thus leveraging efficiencies and achieving more by combining their funds than any one organization could achieve alone. However, CRA frequently takes the position that where a registered charity is funding a portion of the costs of an overall project, it is not carrying out "its own activities" but is rather funding the activities of another organization. Pooled funding projects can only be undertaken where highly cumbersome and limiting requirements are met.

These two examples illustrate the artificiality of the "own activities" requirement. It does not focus on what should be the priority –- whether measures have been taken to ensure that the charity's funds will be used for charitable purposes and whether there is appropriate transparency and accountability over the use of charitable resources. Rather, it focuses on the form of the relationship and "whose activities" are being carried out, neither of which are relevant to the core regulatory objective of ensuring that the resources of a charity are applied to its charitable purposes.

An Inefficient and Costly Burden

Compliance with the "own activities" requirement often results in less funding going to the charitable work. Funds that would otherwise be used directly for a charitable activity are instead spent determining how the activity can be carried out in compliance with the rules, explaining those rules to project partners that are often unfamiliar with the "own activities" paradigm, and negotiating unnecessarily complex agreements to structure the collaboration. This imposes a significant administrative and financial burden, resulting in lost opportunities to engage in charitable work. It is not uncommon for charities with finite resources, particularly those with limited or no full-time staff, to forgo an initiative altogether because of the high costs of implementation.

The inefficiencies and costs of implementing the artificial structures imposed by the rules are exacerbated for charities responding to disasters. Disaster response must occur quickly and frequently requires collaboration with organizations that are set up on the ground to provide support. However, the "own activities" requirements apply equally in the disaster relief context, and require charities to spend precious time and resources developing arrangements that will meet the "own activities" requirement, rather than moving as quickly and efficiently as possible to deliver needed aid in an afflicted area.

Perpetuating a Paternalistic and Colonial Mindset

The current rules impose a hierarchical structure on organizations that wish to work collaboratively. CRA's directives on "direction and control" force charities to impose a

restrictive, paternalistic, and in many cases commercially unreasonable level of control when working with third parties. This top-down approach prevents equal partnerships with local organizations and Indigenous peoples, and instead fosters a patronising attitude which discounts the agency of these marginalized groups.

The words "direction" and "control" themselves are problematic, imposing complex and stringent obligations on intermediary organizations at the direction of the "parent" charity, perpetuating colonialism both in Canada and abroad. Julia Sanchez, Secretary General of ActionAid, has commented that the approach used by international organizations with local organizations is better described using terms such as "solidarity" and "support", rather than "direction and control".[1]

This colonialist mindset is highly problematic for charities working with Indigenous communities in Canada. Many Indigenous organizations are not registered charities and can therefore only receive funding from Canadian charities under arrangements in which they act on behalf and under the direction of the funding charity. The notion that one entity has to control and dictate the actions of another to ensure a certain outcome is inherently paternalistic. The current law and policy goes against the reconciliation efforts with Indigenous organizations and communities across Canada.

This approach also runs counter to international development policy which prioritizes the localization of aid. Canada is a signatory of the Grand Bargain, an agreement between Member States, UN Agencies, inter-governmental organizations and NGOs which represent approximately 84% of all donor humanitarian contributions donated in 2019 and 69% of aid received by agencies. The sixty-two signatories commit to making humanitarian action as local as possible to support, rather than replace, local and national action. This policy of localization recognizes that in most cases, local organizations are better placed to respond than are foreign donor organizations. Canada's own international development policy states that NGOs are expected to "follow partnership principles of local ownership, participation and inclusive decision-making".[2]

No Special Effectiveness at Safeguarding Donor Dollars

These rules might be defensible if they could be shown to be particularly effective at safeguarding donor dollars. However, the artificial structures mandated by the "own activities" requirement do nothing to improve transparency and accountability or provide any greater assurance that funds will be spent on their intended charitable purpose. Accountability and transparency can be provided for equally well regardless of the form of arrangement, while avoiding cumbersome structures.

It is sometimes suggested that the "own activities" regime is necessary to ensure that charitable funds are not misused for terrorist financing. This is inaccurate. Canada's criminal law contains a robust set of anti-terrorism laws, and registered charities are subject to specific legislation that allows for the expedited de-registration of charities that are suspected of involvement in terrorist financing. There is no need to rely on the "own activities" requirement as an indirect means of enforcing an anti-terrorist financing regime. Anti-terrorist financing should be enforced through the specific regulatory tools that were built for this purpose, rather than imposing a one-size-fits

[1] Juniper Glass, "Do Canada's internationally focused charities operate in an enabling environment?" in *The Philanthropist*, April 20, 2015.

[2] Special Senate Committee on the Charitable Sector, *Evidence*, 1st Session 42nd Parliament, 18 March 2019 (Kevin Perkins, Executive Director, Farm Radio International) in *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* at 94.

all regime that does little to further this objective but imposes significant collateral costs on the overwhelming majority of Canadian charities that have nothing to do with terrorism.

A Better Way

Charities should be afforded flexibility with respect to the legal structures they use when working with third parties. Accountability and transparency requirements should not be imposed indirectly through an "own activities" requirement, but rather they should apply directly through provisions that address the actual issues of concern and set out principled requirements that respond to them.

A system focused on expenditure responsibility and/or resource accountability, rather than operational accountability, would allow Canadian charities to more efficiently and effectively engage with organizations domestically and abroad.

The Special Senate Committee on the Charitable Sector recommended in 2019 that the Government of Canada direct CRA to revise its current policies to shift the emphasis on "direction and control" to careful monitoring through the implementation of an "expenditure responsibility test."[3] The expenditure responsibility test would hold charities accountable for how funds are spent, without the requirement that the activities carried out by an intermediary organization are the charity's "own activities".[4]

Ideally, this would also be accompanied by amendments to the *Income Tax Act* that would do away with the "own activities" requirement and replace it with a requirement that a registered charity must take reasonable steps to ensure that its funds are spent on charitable purposes. Bill S-222, just tabled in the Senate on February 8, 2021, proposes changes to the *Income Tax Act* in line with this approach. The changes proposed in that Bill are precisely the type of reform that is urged here.

This would be consistent with an approach that focuses on the purposes, rather than the activities. Instead of requiring the activities to be those of the Canadian charity, the rules would instead provide that the charity must demonstrate that the funds are being used for charitable purposes, including by any third parties.[5]

None of this would circumvent appropriate safeguards over the charitable sector. Accountability over the use of charitable resources is of utmost importance, and any alternative regime must ensure that resources are not misused for the private benefit of individuals, nor misappropriated for criminal and terrorist activities. Operational control is best replaced with an approach that requires reasonable and appropriate steps to ensure resources are devoted to the charitable outcome. It is possible to ensure that funds are used for charitable purposes without having to resort to a complex and onerous regime that is difficult to follow in practice.

Conclusion

The rules regarding charitable work through non-qualified donees, both domestically and abroad, are in need of revision. The COVID-19 pandemic has caused an unprecedented need

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[3] Special Senate Committee on the Charitable Sector. *Catalyst for Change: A Roadmap to a Stronger Charitable Sector*, at 97.

[4] Special Senate Committee on the Charitable Sector, *Evidence*, 1st Session 42nd Parliament, 8 April 2019 (Karen Cooper, Legal Counsel, Drache Aptowitzer LLP) in *Catalyst for Change: A Roadmap to a Stronger Charitable Sector* at 96.

[5] Robert B. Hayhoe, "A Critical Description of the Canadian Tax Treatment of Cross-Border Charitable Giving and Activities" (2001) 49:2/2*, Canadian Tax Journal* 320 at 334.

for the services of charities across the globe. An alternative regime which makes it easier for Canadian charities to fund both organizations abroad and domestic grantee organizations is needed now more than ever.

As lawyers, we have experienced the extent to which charities go to achieve their charitable missions while ensuring compliance with CRA's web of rules regarding operational control of partner organizations. The current rules are inefficient, overly complex, and out of touch with those of other global actors. They create lost opportunities by making it difficult, in some cases prohibitively so, to carry out legitimate charitable work. Further, they impede collaborative partnerships between Canadian charities and their ally organizations across the world.

Not only are the current rules unworkable, they give a false sense of accountability and transparency. The tax-exempt status that charities receive is a privilege. The benefits of such status should not be abused. However, charities cannot serve their purposes to do charitable work with the constraints created by the outdated "own activities" and "direction and control" requirements. It is time for charity law to do away with the inefficiencies created by these antiquated rules, and instead focus on maximizing the charitable work that can be done.

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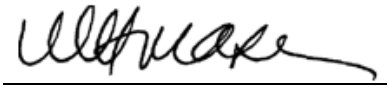
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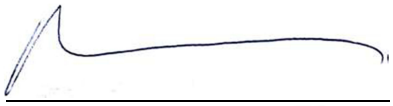
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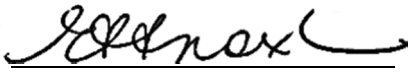
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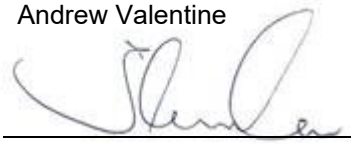
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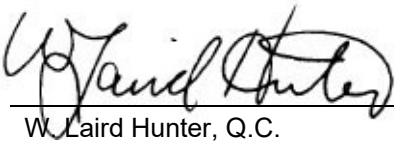
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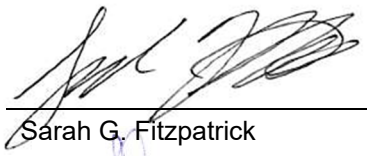
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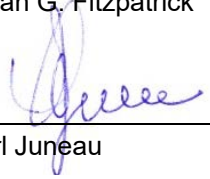
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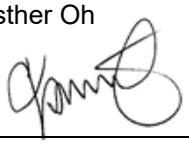
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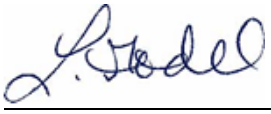
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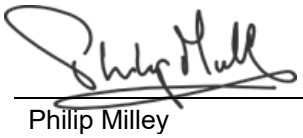

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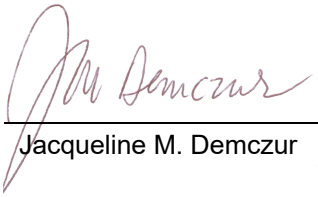

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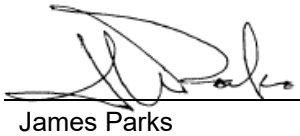

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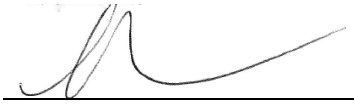

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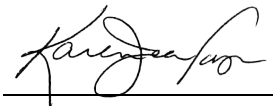

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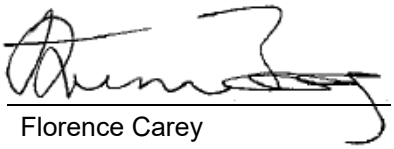

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