

GRANTS TO NON-QUALIFIED DONEES

Canada Revenue Agency (CRA) has posted draft guidance on Registered charities making grants to non-qualified donees. This draft guidance helps clarify what charities need to know in order to make grants to non-qualified donees under the new “qualifying disbursements” definition in the Income Tax Act (ITA).

Summary of the Draft Guidance

The guidance is a long document, and we list the significant elements in detail below. The 5-sentence takeaway is that sufficient documentation for grants is not too different from the documentation charities are required to show when exercising direction and control. However, one very significant difference introduced in the draft guidance is that charities use a risk-based analysis to determine what is necessary in the specific circumstances. High risk scenarios naturally require more due diligence, greater formality and structure to a grant agreement, and grantee reporting. Low risk scenarios, on the other hand, require a lot less background work and need not be as formal. While CRA makes very strong recommendations, there is more flexibility in how charities can demonstrate accountability for grants.

Remind Me, What are Grants?

The ITA answers this question in s 149.1(1), as part of the definition of “qualifying disbursement.” A qualifying disbursement is any transfer of resources from a charity to a qualified donee (gift) or a non-qualified donee (grant) that meets certain conditions.

That means a grant is the transfer of resources to a non-qualified donee, also called a grantee.

All qualifying disbursements, whether a gift or a grant, must further a charitable purpose of the charity; the charity must ensure it is applied exclusively to charitable activities in furtherance of (one of) its charitable purpose(s); and, the charity must maintain sufficient documentation to demonstrate the first two conditions are met.

We’ve answered these and many more basic questions in our Member Resource, Qualifying Disbursements. You can also take a look at our past blogs. They’re all listed at the end of the post Bill C-19 Has Passed – Impact on Direction and Control.

Hands of a variety of shades of skin colour outlining the shape of a heart.

What Does the Draft Guidance Tell Us?

The ITA tells us the legal definition of qualifying disbursements (including grants) but it doesn’t tell us everything we need to know about making grants, most importantly, what documentation will be considered sufficient by CRA when a charity makes a grant. The draft guidance fills in these gaps and provides some context for how this impacts charities and how they operate.

LANGUAGE OF GRANTS

The ITA uses the term “qualifying disbursements.” This term includes both gifts to qualified donees and making grants to non-qualified donees. Charities could already make gifts to qualified donees (other charities). This guidance focuses on grants to non-qualified donees (non-charities).

DIFFERENCES BETWEEN GRANTS & OWN ACTIVITIES (DIRECTION & CONTROL)

The guidance lists 7 differences between rules for grants and rules for ‘own activities’ (direction & control):

Granting opens new opportunities and new ways to work

Granting allows for a collaborative, rather than a hierarchical relationship between the charity and grantee

Granting does not make the grantee a representative of the charity; it carries on its own programs

Granting does not require that the activity be the charity’s initiative; grants can support existing activities by a grantee

Granting does not require ongoing instructions from the charity

Granting does not require the charity to exercise direction and control

Granting focuses on risk and accountability

RELATIONSHIPS CAN CHANGE FROM INTERMEDIARY TO GRANTEE

The draft guidance recognizes that “a charity’s relationship with a non-qualified donee may evolve, and the charity can convert its relationship with the non-qualified donee (for example, from an intermediary to grantee relationship.”

How? A charity needs to document the “change in its books and records and be sure to meet all requirements at the time of the change.”

SUFFICIENT DOCUMENTATION FOR MAKING GRANTS

CRA’S FLEIXBLE APPROACH

Charities have to ensure and demonstrate in their books and records that it meets accountability requirements.

CRA is taking a “reasonable and flexible approach when determining whether a charity has met the accountability requirements.” The accountability tools CRA identifies are “not exhaustive and their suitability depends on the circumstances of individual grants.” Where charities use different tools, they need to explain why in their books and records. Charities should also use a consistent approach to making grants.

CRA'S RECOMMENDED PROCESS

There are four main steps:

How does the grant further your charitable purposes?

What is the grant's risk level – low, medium or high?

What accountability tools should you use based on the risk level?

How should those accountability tools be applied to each grant?

STEP ONE: CHARITABLE PURPOSES

This should be a familiar and consistent part of a charity's operational decisions: does the proposed project, activity, grant, etc. further one or more of your organization's charitable purposes? If yes, how? Be sure to record these considerations and conclusions in your charity's books and records.

STEP TWO: RISK ASSESSMENT

Risk factors (higher risk listed first) include:

Charity's experience – no, some, or significant grant experience?

Grantee's experience – new grantee, some, or extensive programming experience?

Grant activity location – outside or inside Canada? Stable or unstable? Lack of, unreliable, or reliable infrastructure (banks, internet)? No, some, or extensive experience in that location?

Grant amount – high (\$25,000+), moderate (\$5,000-\$25,000), or low (up to \$5,000)?

Private benefit concerns – significant, some or limited/little concern?

Nature of resources granted – susceptible to non-charitable use (cash, crypto, real property), somewhat susceptible (mix of cash and others) or not susceptible (textbooks, medical supplies)?

Grant duration – long term with no end date, long term with an end date (1-2 years) or short term (less than 1 year)?

Where the risk level changes during the course of a grant, charities should re-visit their due diligence process to determine what changes, if any, should be made to the terms of the grant.

Some examples of increased risk include: financial collapse in nation/region of activity, poor quality grantee reports, discovering private benefit, change in grantee's leadership.

Some examples of decreased risk include: financial stabilization, peace established in nation/region of activity, strong track record with a grantee, grantee exceeds expectations, decreased value in charitable resources.

Chalkboard background; a hand holding a cell phone on each side with dollar bills drawn in white chalk in the shape of an arc between the phones.

STEP THREE: ACCOUNTABILITY TOOLS

Due diligence review of the grantee

For due diligence, the higher the risk, the more extensive the review needs to be.

What should charities assess? Charities should assess the grantee's purposes and mission, programs, history, reputation, staff, volunteers, associated people or entities, experience and capacity to carry on the grant activity, and the potential use of the grant.

How can the review be done? Charities can do independent research, make in-person visits, have virtual meetings, request information from the grantee, review past grant outcomes, and read letters of reference/support.

What if you already have a working relationship with the grantee? Charities that have “already formed a successful working relationship with a grantee” may not need to conduct an “extensive” review.

What if you can't do an extensive review? Charities “may wish to consult with experts, community leaders, or other charities” about the risks and document the steps it does take.

Description of grant activity

For grant activity descriptions, the higher the risk, the more detailed the written description needs to be.

What should charities describe? Charities should consider including the activity and charitable purpose(s) it furthers, location of grant operations, start and end dates, public benefit, how to address unacceptable private benefit, deliverables/objectives, any third parties the grantee will use to carry out the activity, and

any accountability tools that will be used.

Where should the description be kept? Charities should keep the description in their books and records, review it with the grantee, and include it in any written agreement.

Written agreement

For written agreements, higher risk requires a formal agreement, whereas lower risk agreements can be simple. Where less than \$5000, documentation alone is likely sufficient.

Why should charities use written agreements? It documents the grant, its charitable purpose and budget, it clarifies expectations, it confirms terms and conditions, and it keeps grants on track. CRA recommends that charities have a written agreement for every grant.

What about grants less than \$5000? For non-recurring grants written agreements may not be required. For “very low risk circumstances” other documentation may be enough (emails, meeting minutes). If the grants will be ongoing (e.g. annually), CRA recommends a written agreement.

What if charities can't use written agreements? The charity should explain the reason in its books and records and have other documentation.

What should charities include in written agreements? Charities can include a myriad of information in a written agreement: legal names and addresses, signatures of authorized persons, signing date, intention to make a grant (versus intermediary), description(s) of activity, charitable purpose it furthers, location of activity, start and end dates of funding/the relationship, reporting requirements, a right to inspect, periodic transfer of funds with and any applicable conditions, right to require return of unused resources, requirement of separately tracked funds, limit use of resources for only charitable purposes, effective date, and termination provisions.

Monitoring and reporting

For monitoring and reporting, higher risk requires detailed, written, and final (and possibly interim) reports. Lower risk would only need a simple, written, final report. CRA recommends that every grant require a final written report with supporting documentation (where appropriate).

What kind of monitoring and reporting should charities do? Monitoring and reporting could include final reports with documentation, interim reports, expense receipts, financial statements, records of phone, email, and video communications, photos and videos, audit reports, and records from on-site visits by charity staff.

What should a charity do with the reports? Charities should record in their books and records that they have reviewed the final reports, and briefly explain why they are satisfied with them.

Transfer schedule

For transfer schedules: higher risk requires a transfer schedule; it should likely be used for medium risk; and is a consideration for lower risk.

Why should charities use a transfer schedule? Charities should use a transfer schedule because it allows a charity to mitigate losses if resources are not used according to the agreement.

What if charities don't use a transfer schedule? The reason should be recorded in charities' books and records.

Separately tracked funds

For separately tracked funds, all levels of risk should have this in place.

Why should charities require separately tracked funds? Charities should require separately tracked funds because it helps them document use of the grant.

What does it mean to have separately tracked funds? Separately tracked funds does not require separate books and records or a separate bank account. Instead, it means that the grantee can track the funds with enough detail to report back to the charity. It is preferable if the grant can be separately tracked in the grantee's books and records.

LIMIT ON GRANTS

The guidance confirms that charitable organizations can disburse no more than 50% of their income by way of gifts to qualified donees (other charities). Disbursing more means that the charity would be re-designated as a foundation.

The guidance also confirms that charitable organizations can disburse unlimited amounts by making grants to grantees (non-qualified donees).

PROHIBITION ON DIRECTED DONATIONS: CLARITY

The ITA requires that charities cannot accept gifts that are expressly or implicitly conditional on the charity granting it to a specific recipient.

The guidance confirms that “provided a charity ensures it retains authority on the use of its resources, it will not be considered to be engaged in directed giving,” even if a donor has indicated a preference for how the donation will be used.

How does a charity ensure it retains authority on the use of its resources? Charities should clearly communicate that (1) they retain ultimate authority on how it uses its resources, and (2) they will not return the donation to donors if the donation is not used the way the donor prefers.

What's the point of this prohibition? The purpose is to prevent a charity from existing "solely ... as a fundraising arm in Canada of an affiliate organization in another country."

REPORTING GRANTS

The ITA already set out the requirements for reporting: for every grant over \$5,000, the granting charity must report the name of the grantee, the purpose of the grant, and the total yearly amount granted to the grantee.

What about security concerns? Charities can apply to CRA to request that some of the information not be publicly disclosed "if its release would place the charity, grantee, their staff, or volunteers in danger."

POOLED GRANTS

The draft guidance outlines specific accountability tools that are expected of charities participating in pool grants. It also provides additional factors to determine whether the pooled grant is higher risk. If charities cannot use the recommended accountability tools, CRA "recommends approaching pooled grants cautiously" and that legal advice may be prudent.

GRANTING CHARITABLE GOODS

The draft guidance outlines specific accountability tools that are expected of charities granting charitable goods. It is a low-risk activity so long as the resources could only reasonably be used for charitable purposes.

GRANTING REAL PROPERTY

The draft guidance outlines specific accountability tools that are expected of charities granting real property. It is a high-risk activity because it is very difficult to ensure that the property will be permanently used for charitable purposes. Where the risk of non-charitable use is "greater than the benefit that may be provided" CRA's position is that the charity should not grant the property. CRA also recommends contacting the Charities Directorate before granting any real property.