

# **SUMMARY OF DISBURSEMENT QUOTA RULES**

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## DISBURSEMENT QUOTA REQUIREMENTS

### What is the disbursement quota?

The disbursement quota is a prescribed amount (the quota) that registered charities are required under the *Income Tax Act* (Canada) (the “*Act*”) to disburse each year in order to maintain their charitable registration. In particular, it is a prescribed amount that must be spent each year in a charitable capacity. The purpose of the disbursement quota is to ensure that charities use the bulk of their tax receipted gifts on charitable activities/purposes. It is intended to discourage charities from spending excessive amounts on fund raising and from accumulating excessive funds. There are different disbursement quotas for the three categories of registered charities, namely, charitable organizations, public foundations and private foundations.

### What is the disbursement quota for charitable organizations?

A charitable organization is required to disburse the following per year:<sup>1</sup>

1. 80 per cent of all amounts for which it issued official donation receipts in its *preceding* taxation year excluding donation receipts issued for the following:
  - (a) gifts of capital received under a will (“bequests”);
  - (b) gifts subject to a trust or direction that the gift, or property substituted for it, be held for at least 10 years; and
  - (c) gifts received from other registered charities.<sup>2</sup>
2. 80 per cent of the following amounts that were excluded from the disbursement quota in a previous year but were spent in this fiscal period:<sup>3</sup> (i) gifts of capital received under a will *after* 1993<sup>4</sup> and (ii) gifts subject to a trust or direction that the gift, or property substituted for it, be held for at least 10 years.

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<sup>1</sup> The definition of “disbursement quota” provided in subsection 149.1(1) of the *Act* is applicable only to charitable foundations. Paragraph 149.1(2)(b) of the *Act* renders this definition applicable to charitable organizations in a modified form.

<sup>2</sup> It should be noted, however, that typically donation receipts will not be issued for gifts made between charities. Whether or not a donation receipt is issued, a gift received by a charitable organization from another registered charity will not be subject to the charitable organization’s disbursement quota.

<sup>3</sup> The 80 per cent requirement applies only to the portion of the previously excluded amount that is actually spent by the charity in a subsequent year. As an example, assume that in 1990 a charity issued a receipt for a \$10,000 gift that was subject to the direction that it be held by the charity for ten years. This \$10,000 will not be subject to the 80 percent disbursement quota for 1991. If, however, in 2001, after the expiration of the ten years, the charity spends \$5,000 of the \$10,000 ten year gift, that \$5,000 will be included in the charity’s disbursement quota for 2001. 80 per cent of the \$5,000 will therefore need to have been disbursed directly on charitable activities. (What it means to disburse money directly on charitable activities is discussed in greater detail below.)

<sup>4</sup> Bequests of capital received prior to 1994 will never be subject to the 80 per cent disbursement quota.

## What is the disbursement quota for public foundations?

A public foundation is required to disburse the following per year:<sup>5</sup>

1. 80 per cent of all amounts for which it issued official donation receipts in its *preceding* taxation year excluding donation receipts issued for either of the following:
  - (a) gifts of capital received under a will (“bequests”);<sup>6</sup> and
  - (b) gifts subject to a trust or direction that the gift, or property substituted for it, be held for at least 10 years.
2. 80 per cent of all amounts received by it from other registered charities in the preceding taxation year whether or not an official donation receipt was issued except for “specified gifts”.<sup>7</sup> (Specified gifts are described below.)
3. 80 per cent of the following amounts that were excluded from the disbursement quota in a previous year but were spent in this fiscal period:<sup>8</sup> (i) gifts of capital received under a will *after 1993* and (ii) gifts subject to a trust or direction that the gift, or property substituted for it, be held for at least 10 years.
4. 4.5 per cent of the product obtained when the following three amounts are subtracted from the average value of the foundation’s “investment property”:
  - 100 per cent of the amount for which official donation receipts were issued in the preceding year including donation receipts issued for amounts received from other registered charities but not including donation receipts issued for gifts of capital received under a will and gifts subject to a trust or direction that the gift, or property substituted for it, be held for at least 10 years.
  - 100 per cent of the amounts received from other registered charities for which no official donations receipts were issued except for “specified gifts”.

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<sup>5</sup> See definition of “disbursement quota” in s. 149.1(1) of the *Act*.

<sup>6</sup> In Technical Interpretation 9131785, Canada Customs and Revenue Agency took the position that capital “should not be interpreted broadly to include all sources of funding received by way of bequest or inheritance”. A charity therefore should not simply assume that a charitable gift constitutes a bequest of capital simply because it was made pursuant to the terms of a will. For example, if a charity is designated in a will as the income beneficiary of a trust established under that will, the charity will have received an income interest rather than a bequest of capital.

<sup>7</sup> There is no reason to issue donation receipts for gifts received from other registered charities. The reason for this is that registered charities are tax exempt and, as a result, do not need an official donation receipt in order to receive favourable tax treatment for their gifts to charities. The exemption of specified gifts from the disbursement quota does not turn on whether a donation receipt was issued.

- 100 per cent of amounts under 1(a) or (b) above that were excluded from the disbursement quota in a previous year but were spent in this fiscal period.

“Investment property” includes any real estate or personal property, or part of such property, that (i) was owned by the foundation at any time in the 24 months preceding the fiscal period covered by the tax return and (ii) was not used directly for charitable programs or administration.

### **What is the disbursement quota for private foundations?**

The disbursement quota for private foundations is identical to that for public foundations with one exception. Whereas public foundations must disburse 80 per cent of all amounts received from other registered charities in the preceding taxation year (except for specified gifts), private foundations must disburse 100 per cent of such amounts.<sup>9</sup>

### **How is the average value of a charitable foundation’s investment property calculated?**

The method for calculating the average value of a charitable foundation’s investment property is set out in Regulations 3700 to 3702 under the *Act*.

### **Are gifts received by registered charities from other registered charities subject to the disbursement quota?**

The answer to this question varies with whether the donee charity is a charitable organization or a foundation. Gifts received by charitable organizations from other registered charities are not subject to the charitable organization’s disbursement quota. However, for public foundations the general rule is that the foundation must disburse at least 80 per cent of all amounts received by it from other registered charities in the preceding taxation year. (As indicated above, private foundations must disburse 100 per cent of such amounts.) These rules apply irrespective of whether the foundation issues official donation receipts for these gifts and, while the matter is not free from doubt, appear to apply irrespective of whether the gifts are 10 year gifts. “Specified gifts” constitute an exception to this general rule. (See below.)

### **What is a “specified gift”?**

Specified gifts are gifts given from one charity to another that are designated as specified gifts in the donor charities’ information return for the year in which the gift is made.<sup>10</sup> Specified

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<sup>8</sup> As indicated above, the 80 per cent requirement applies only to the portion of the previously excluded amount that is actually spent by the charity in a subsequent year.

<sup>9</sup> See the definition of variable “B” contained in the definition of “disbursement quota” under s. 149.1(1) of the *Act*.

<sup>10</sup> Subsection 149.1(1) of the *Act*.

gifts neither increase the disbursement quota of the donee charity nor count towards satisfaction of the disbursement quota of the donor charity.

Any charity that receives a gift from another registered charity should inquire whether the donor charity is going to designate the gift as a specified gift in its information return for the year. The rationale for this varies with whether the donee is a foundation or a charitable organization.

Foundations should make this inquiry because gifts received by foundations from other registered charities will be exempt from the donee foundation's disbursement quota *only* if the donor charity plans to designate the gift as a specified gift in its information return for the year. This rationale does not apply to charitable organizations because a gift received by a charitable organization from another registered charity will be exempt from the disbursement quota of the donee organization whether or not the gift is designated by the donor charity as a specified gift.

Charitable organizations should nevertheless make this inquiry because specified gifts are not included in the calculation of the income of charitable organizations.<sup>11</sup> This is significant because charitable organizations are not allowed to disburse more than 50 per cent of their *income* in any year to qualified donees.<sup>12</sup> Charitable organizations therefore need to know whether gifts from other registered charities are specified gifts in order to determine how much they can disburse to other qualified donees without running afoul of the 50 per cent rule. Since foundations are not bound by the 50 per cent rule, this rationale does not apply to them.

### **What are the disbursement quota implications of “10 year gifts”?**

A 10 year gift is a gift that is made subject by the donor to a trust or direction that the gift, or property substituted for it, be held by the donee charity for a “period of not less than 10 years” (the “Hold Period”).<sup>13</sup> Canada Customs and Revenue Agency (“CCRA”) requires that 10 year gifts be evidenced by writing that meets the following criteria:<sup>14</sup>

- the document must be executed by the donor;
- the document must clearly identify the donee charity, including its official name and registration number;
- the document must indicate the amount of the gift;
- the document must set out the date the gift is made;
- the document must set out the name and address of the donor; and
- the document must set out the serial number of the official receipt issued to the donor for the gift.

In addition, a deed of gift creating a 10 year gift should at the minimum be drafted with a view to the following general considerations:

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<sup>11</sup> Paragraph 149.1(12)(b) of the *Act*.

<sup>12</sup> Paragraph 149.1(6)(b) of the *Act*.

<sup>13</sup> See the definition of variable “A” contained in the definition of “disbursement quota” under s. 149.1(1) of the *Act*.

<sup>14</sup> Information Circular 80-10R “Registered Charities: Operating a Registered Charity” at paragraph 37.

- The *Act* stipulates that the minimum Hold Period for a 10 year gift is ten years. There is no maximum Hold Period stipulated in the *Act*. The deed of gift should therefore specify whether the Hold Period is ten years, perpetuity or some other period of time not less than ten years.
- It is not necessary for a 10 year gift to constitute a trust. The *Act* merely provides that the gift must be subject to either a “trust or direction” that the gift, or property substituted for it, be held for a period of not less than ten years.<sup>15</sup> It is therefore not necessary for the deed of gift to satisfy the “three certainties” for a trust in order for there to be a valid 10 year gift.
- The deed of gift should specify what, if any, donor restrictions will apply to the use of the 10 year gift after the expiration of the Hold Period.
- CCRA does not consider capital gains earned on 10 year gifts to constitute “income”. (This bodes critical disbursement quota considerations that are discussed below.) While a donor is free to stipulate in the deed of gift that income includes capital gains, it does not appear as though such a stipulation will trump CCRA’s characterization of capital gains for disbursement quota purposes.

In considering the disbursement quota implications of 10 year gifts, it is critical to bear in mind the following general rules:

#### **Limited Exemption from the 80 Per Cent Disbursement Quota:**

A 10 year gift, or property substituted for it, will provide a charity with a limited measure of relief from its disbursement quota obligations. First, the income earned on a 10 year gift, or property substituted for it, is at no time included in the calculation of a charity’s disbursement quota. Second, as indicated above, a 10 year gift, or property substituted for it, is exempt from the rule applicable to all registered charities (including charitable organizations and foundations, both private and public) requiring the disbursement of 80 per cent of the previous year’s receipted donations. This latter exemption, however, is a limited exemption. A 10 year gift is exempt from the 80 per cent disbursement quota only until such time as the gift, or property substituted for it, is expended.<sup>16</sup> The portion of the 10 year gift subject to the 80 per cent disbursement at this time will depend, *inter alia*, upon whether the gift is expended prior to or after the expiration of the Hold Period.

If the 10 year gift, or property substituted for it, is expended *after* the expiration of the Hold Period, then only that portion of the gift expended will at that time be subject to the 80 per cent disbursement quota.<sup>17</sup> If the 10 year gift, or property substituted for it, is expended *prior* to the expiration of the Hold Period, then the entire gift *may* collapse and become subject to the 80

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<sup>15</sup> See the definition of variable “A” contained in the definition of “disbursement quota” under s. 149.1(1) of the *Act*.

<sup>16</sup> See the definition of variable “A.1” contained in the definition of “disbursement quota” under s. 149.1(1) of the *Act*.

<sup>17</sup> See footnote 4 above.

per cent disbursement quota.<sup>18</sup> The word “may” is used here to connote that the administrative practices of CCRA are at present unclear on this point. We note, however, that the language used in the *Act* suggests that only that portion of the 10 year gift, or property substituted for it, actually expended will become subject to the 80 per cent disbursement quota.

It is important to note that capital gains earned on 10 year gifts are not considered by CCRA to constitute income earned on such gifts. Instead, CCRA considers capital gains as property substituted for the original gift. The expenditure of capital gains earned on 10 year gifts will therefore result in the disbursement quota consequences described in the preceding paragraph (depending upon whether the capital gain was expended prior to or after the expiration of the Hold Period).

### **Application of 4.5 Per Cent Disbursement Quota:**

As indicated above, charitable foundations (but not charitable organizations) are required to disburse an amount equal to 4.5 per cent of the average value of their “investment property”.<sup>19</sup> A 10 year gift, or property substituted for it, is subject to this 4.5 per cent disbursement requirement. The reason for this is that a 10 year gift, or property substituted for it, constitutes investment property.

The consequence of this is that the 10 year gift must generate at least 4.5 per cent in income per year to ensure that the foundation has sufficient funds available to satisfy the 4.5 per cent disbursement requirement in respect of the gift (unless, of course, the foundation has other monies that could be expended for this purpose). As indicated above, prior to the expiration of the Hold Period, the foundation may not, without collapsing the entire gift, be able to realize capital gains in order to meet this disbursement requirement. Capital gains may, however, be realized in order to meet the 4.5 per cent disbursement requirement after the expiration of the Hold Period without collapsing the entire gift.

### **10 Year Gift Given to a Foundation By Another Registered Charity:**

As indicated above, charitable foundations (but not charitable organizations) have included in the calculation of their disbursement quota gifts received the preceding year from other registered charities. Public foundations are required to disburse 80 per cent of such amounts whereas private foundations are required to disburse 100 per of such amounts. This raises the question of whether 10 year gifts received by charitable foundations from other registered charities are subject to these disbursement requirements just like any other gift received by a foundation from another charity.

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<sup>18</sup> Completely apart from disbursement quota considerations, the expenditure of a 10 year gift prior to the expiration of the Hold Period may constitute a breach of trust.

<sup>19</sup> This is not completely accurate, since, as indicated above, certain amounts are subtracted from the average value of the foundation’s investment property before the 4.5 per cent disbursement requirement is calculated.

While the matter is not free from doubt, it does not appear as though a 10 year gift will be exempt from these disbursement requirements if the donee of the gift is a foundation, private or public, and the donor is another registered charity.<sup>20</sup> This is not the case for charitable organizations, since, as indicated above, gifts received by a charitable organization from other registered charities are not included in the calculation of its disbursement quota.

In any event, a foundation in receipt of a 10 year gift from another registered charity could bring an application under subsection 149.1(5) to have the gift excluded from the calculation of its disbursement quota. CCRA has indicated during informal discussions that it will in certain circumstances exempt such gifts from the donee foundation's disbursement quota. Where CCRA grants such an exemption, the exemption will be conditional. CCRA may, for example, stipulate that the 10 year gift will not be exempt from the 4.5 per cent disbursement requirement but will nonetheless be exempt from the 80 per cent disbursement quota (which, in the case of private foundations, is 100 per cent) until such time as the gift is actually expended. The particular conditions attached by CCRA will depend upon the circumstances in question.

### **Transferring A 10 Year Gift From One Charity to Another Charity As a Specified Gift:**

As discussed above, specified gifts are a way to transfer gifts from one charity to another charity in a manner that has neutral disbursement quota implications. It should not be assumed, however, that a charity may transfer a 10 year gift to another charity as a specified gift in order to avoid any undesirable disbursement quota consequences. The way the *Act* is currently drafted the transfer of a 10 year gift from one charity to another will be treated as an expenditure of the 10 year gift by the transferor charity, even if the transfer is designated as a specified gift. This will result in the entire 10 year gift being brought into the transferor charity's disbursement quota. The disbursement quota implications of this will not be neutral since the designation of the 10 year gift as a specified gift means that the transfer of it by the transferor charity will not count as a transfer to a qualified donee in satisfaction of the transferor's disbursement quota.<sup>21</sup>

### **How have low interest rates adversely affected the ability of charitable foundations to meet their disbursement quota?**

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<sup>20</sup> See the definition of disbursement quota under s. 149.1(1) of the *Act*. The definitions of variables A and A.1 exclude 10 year gifts from the 80 per cent disbursement quota until such time as they are expended. However, the definition of variable B, which is applicable only to foundations, brings back into the disbursement quota all gifts received from other registered charities. While the *Act* is not entirely clear on this point (and there are no relevant technical interpretations that we are aware of), it would appear as though a 10 year gift given by a registered charity to a foundation that was excluded from the disbursement quota under variable A will nonetheless be included in the disbursement quota under variable B.

<sup>21</sup> See the definition of variable "A.1" contained in the definition of "disbursement quota" under s. 149.1(1) of the *Act*. This variable is defined in such a way as to include in the disbursement quota that portion of a 10 year gift that "is expended in the year". Since this definition does not stipulate "expended in the year *otherwise than by way of specified gift*", it makes no difference that the transfer of the 10 year gift is designated as a "specified gift".



Low interest rates have recently revealed a technical problem with the drafting of the disbursement quota requirements in the *Act*. As indicated above, charitable foundations are required to expend an amount equal to 80 per cent of total amount for which charitable gift receipts were issued in the preceding year plus 4.5 per cent of the average value of the foundation's investment property. Gifts of capital received by way of bequest and ten-year gifts are exempt from the 80 per cent disbursement quota requirement until such time as they are expended. At the time that they are expended, the expended portion is subjected to the 80 per cent disbursement quota. (As indicated above, however, the expenditure of a portion of a ten year gift prior to the expiration of the "hold period" may subject the entire gift to the 80 per cent disbursement quota.)

When interest rates are low, a foundation may not be able to meet the 4.5 per cent disbursement obligation without expending a portion of the capital of the bequest or ten-year gift. The difficulty is that the 80 per cent and the 4.5 per cent disbursement obligations are *cumulative*. Therefore, 80 per cent of the expended portion of the capital would be required to satisfy the 80 per cent disbursement requirement and this would leave only 20 per cent of the expended portion to satisfy the 4.5 disbursement obligation.

Consider a gift of capital under a will. If the charity had to draw \$45,000 from capital to satisfy the 4.5 per cent disbursement quota, it would therefore have to expend a total of \$225,000 from capital due to the combined effect of the 80 per cent and 4.5 per cent disbursement quotas. (\$45,000 = 20 per cent of \$225,000 leaving \$180,000, which is 80 per cent of \$225,000, to satisfy the 80 per cent disbursement obligation). CCRA has been made aware of this problem and is looking into it.

### **What expenditures count towards satisfying the disbursement quota?**

Not all expenditures count towards satisfaction of the disbursement quota. In determining whether a charity has met its disbursement quota, only those monies disbursed (i) to qualified donees or (ii) directly on charitable activities should be taken into account.

#### Qualified Donees:

"Qualified donee" is defined in subsection 149.1(1) of the *Act* to include the following:

- registered charities;
- registered Canadian amateur athletic associations;
- registered national arts service organizations;
- housing corporations resident in Canada constituted exclusively to provide low-cost housing for the aged;
- the United Nations and its agencies;
- universities outside Canada listed in Schedule VIII of the *Income Tax Regulations*;

- charitable organizations outside Canada to which Her Majesty in right of Canada (the federal government or its agents) has made a gift during the charity’s fiscal period or in the 12 months immediately preceding the period;
- municipalities in Canada; and
- Her Majesty in right of Canada or in right of a province (that is, the federal government, a provincial government, or their agencies).

The disbursement of moneys to any of these organizations will count towards satisfying the disbursement quota.

Charitable Activities:

CCRA will consider money to be spent directly on charitable activities when its expenditure is essential to providing the charitable program. This includes the salaries of persons performing, or assisting in the performance of, actual charitable work and disbursements for equipment used in charitable activities. It does not include amounts spent on management, general administration and fund-raising.<sup>22</sup>

Money spent on “deemed charitable activities” will not count towards the disbursement quota in all instances. The *Act* deems money spent by charities on certain political activities to be money spent in furtherance of its charitable activities/purposes.<sup>23</sup> Nevertheless, the *Act* provides elsewhere that such expenditures do not count towards the charities’ disbursement quota.<sup>24</sup>

**Once the disbursement quota has been met, can a charity disburse funds to another charity that does not constitute a qualified donee?**

The *Act* does not specifically contemplate how a charity may disburse funds *after* it has met its disbursement quota for the year. Nevertheless, in the case of charitable organizations, it is clear that once the disbursement quota has been met, the charity is not free to disburse funds to other charities that do not constitute qualified donees, such as, for example, foreign charities.<sup>25</sup> The reason for this is that a charitable organization is by definition a charity that devotes all of its

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<sup>22</sup> Paragraph 36 of IC 80-10R.

<sup>23</sup> See subsection 149.1(6.1) of the *Act* for charitable foundations and subsection 149.1(6.2) for charitable organizations. The political activities must be ancillary and incidental to the charity’s charitable activities/purposes and must not include the direct or indirect support of, or opposition to, any political party or candidate for public office. For more information on permissible political activities, see Information Circular 87-1 “Registered charities - Ancillary and Incidental Political Activities”.

<sup>24</sup> Subsection 149.1(1.1) of the *Act*.

<sup>25</sup> Foreign charities are an example of entities that constitute charities at common law but do not necessarily constitute qualified donees. See the definition of “qualified donee” referred to above.

resources to charitable activities carried on by the organization itself.<sup>26</sup> An exception to this rule is contained in paragraph 149.1(6)(b) of the *Act*, which provides that a charitable organization may disburse up to 50 per cent of its income to qualified donees and still be considered to be devoting its resources to charitable activities carried on by itself. Since a charitable organization must either carry on charitable activities directly through its own programs or indirectly through limited disbursements to qualified donees, it cannot disburse funds to a foreign charity that does not constitute a qualified donee.<sup>27</sup>

This is not the case, however, when it comes to charitable foundations. The *Act* requires of charitable foundations that they, *inter alia*, be “constituted and operated exclusively for charitable purposes”.<sup>28</sup> In turn, the *Act* defines “charitable purposes” as merely *including* the disbursement of funds to qualified donees.<sup>29</sup> In other words, the *Act* does not *restrict* the definition of “charitable purposes” to the disbursement of funds to qualified donees or to the performing of charitable activities directly by a charitable foundation. It would therefore seem that once a foundation has met its disbursement quota for the year (which, as indicated above, requires that the prescribed amount be spent directly on charitable activities or indirectly through gifts to qualified donees), it is free to disburse funds to charities that do not constitute qualified donees.

This practice was approved of by CCRA several years ago. Nevertheless, CCRA recently reversed its position on this issue as is set out in the CCRA Registered Charities Newsletter No. 9 dated June 6, 2000. CCRA now takes the position that neither charitable organizations nor foundations may disburse funds to a charity that is a non-qualified donee even if (i) the donor charity’s disbursement quota is met and (ii) the donee constitutes a charity at common law. Based on this new position, CCRA recently took action against a foundation that was disbursing excess funds available after it had it met its disbursement quota to non-qualified donees. The matter was settled when the private foundation challenged CCRA’s interpretation. In agreeing to settle, CCRA acknowledged that as the *Act* and the regulations passed under it currently stand, the foundation could disburse funds to a non-qualified donee provided that the foundation’s disbursement quota was met and the non-qualified donees constituted charities at common law. The minutes of settlement, however, disclose that the *Act* is likely to be amended in the future to prohibit this practice. Caution is therefore recommended on this front.

### **What happens if the disbursement quota is exceeded in a particular taxation year?**

There will be a disbursement excess for a particular year where all amounts expended by a charity on charitable activities carried on by it or by way of gifts to qualified donees (but not including specified gifts or expenditures on political activities) exceed its disbursement quota for the year.

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<sup>26</sup> See definition of “charitable organization” in s. 149.1(1) of the *Act*.

<sup>27</sup> A charitable organization may, however, *transfer* funds to a non-qualified donee *if* the donee is using the funds on behalf of the organization to carry out the organization’s activities. For more information in this respect, see the CCRA publication called *Registered Charities: Operating Outside Canada* (RC4106E).

<sup>28</sup> See definition of “charitable foundation” in s. 149.1(1) of the *Act*

<sup>29</sup> See definition of “charitable purposes” in s. 149.1(1) of the *Act*.

A charity can employ a disbursement excess in one of two ways:<sup>30</sup>

1. The disbursement excess can be applied against a disbursement shortfall occurring in the immediately preceding taxation year; or
2. The disbursement excess can be drawn on for up to five subsequent taxation years to help the charity meet its disbursement quota in those years. The excess expenditures need not be evenly spread over the five years. That portion of a disbursement excess used in one year cannot be used in any of the remaining carryover years.

### **What happens if the disbursement quota is not met in a particular taxation year?**

The *Act* provides that a charity may have its charitable registration revoked for failure to meet its disbursement quota in a particular year.<sup>31</sup> In practice, however, de-registration is not likely to occur unless there have been continuous failures to meet the disbursement quota.

Apart from de-registration, the *Act* provides two ways of dealing with disbursement shortfalls:

1. As indicated above, disbursement excesses from the preceding five taxation years and/or from the immediately subsequent taxation year may be applied against disbursement shortfalls.
2. A charity may apply to have its disbursement quota reduced for the particular taxation year.<sup>32</sup> This requires that the charity make an application in prescribed form (T2094). Such an application will be successful only if the disbursement shortfall is due to extraordinary circumstances beyond the charity's control. It is unlikely that such an application would be successful in circumstances where the disbursement shortfall could be remedied through the carryover of disbursement excesses as described above.

### **How can a charity accumulate funds for large-scale projects and still meet its disbursement quota?**

It was indicated above that one of the objectives of the disbursement quota is to prevent charities from accumulating excessive funds. One negative consequence of this is that meeting its disbursement quota can prevent a charity from accumulating sufficient funds to make major purchases out of cash and to thereby escape the interest costs associated with financing such purchases.

There are, however, three basic methods whereby a charity may accumulate property for large-scale projects without running the risk of disbursement shortfalls:

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<sup>30</sup> Subsection 149.1(20) of the *Act*.

<sup>31</sup> Paragraph 149.1(3)(b) of the *Act*.

<sup>32</sup> Subsection 149.1(5) of the *Act*.

1. It may apply under subsection 149.1(8) of the *Act* for permission to accumulate property. (There is no specific application form.) The application must specify the purpose for which the charity wants to accumulate property, the amount required to be accumulated and the length of time over which the charity will need to accumulate the property.

If the application is approved, then the amount of the property accumulated during each year of the accumulation period, including the income earned on this property, will count towards the charity's disbursement quota in each year. The ultimate expenditure of the accumulated funds at the end of the accumulation period will have no impact on the disbursement quota in the year of expenditure. (This is to avoid having the same funds counted twice towards satisfaction of the disbursement quota.)

If the application is approved and the accumulated property is not used for the specified purpose within the required time, then subsection 149.1(9) requires that the accumulated property, including the income earned on it, be included in the charity's income as receipted income. The timing of this will be the earlier of (i) the expiration of the accumulation period or (ii) the time at which the charity decided not to use the property for the specified purpose. This will increase the disbursement quota requirement for the following taxation year.

2. It can encourage its donors to donate gifts subject to a trust or direction that the gifts, or property substituted for them, be held for at least 10 years. Ten year gifts are exempt from the 80 per cent disbursement quota until the year in which they are spent (at which time the portion of the gift that is expended is subject to the 80 per cent disbursement quota).

It is recommended, however, that caution be exercised when consideration is being given to the disbursement quota implications of ten year gifts. First, as indicated above, not all ten year gifts are exempt from the 80 per cent disbursement quota. Ten year gifts given from a registered charity to a foundation are not exempt from the foundation's 80 per cent disbursement quota. Second, as also indicated above, it is critical to distinguish between the income earned on ten year gifts and capital gains earned on such gifts. The income earned on ten year gifts will in no circumstances be subject to either the 80 per cent or the 4.5 per cent disbursement quotas of foundations. The income earned on ten year gifts can therefore be used to meet the disbursement quota associated with the capital gains earned on ten year gifts.

Capital gains earned on ten year gifts are subject to *both* the 80 per cent and the 4.5 per cent disbursement quotas. Capital gains are subject to the 4.5 per cent disbursement quota because they increase the average value of a foundation's investment property. Capital gains will be subject to the 80 per cent disbursement quota in the year, if ever, in which they are expended (not the year in which they are earned). It should be noted that if capital gains are expended in a year *prior* to the expiration of ten years from the time that the gift was given then the entire ten year gift may be subjected to the 80 per cent disbursement quota in that year (although, as indicated above, the law and administrative practices of CCRA are at present unclear on this point).

3. It can encourage its donors to leave bequests of capital to it. These gifts are not subject to the 80 per cent disbursement quota until the year in which they are expended and even then only to the extent that they are expended.<sup>33</sup> If, however, the gift constituted investment property (as defined above) then it would be subject to the 4.5 per cent disbursement quota applicable to foundations.

Of these three methods of accumulating property for large scale projects the most preferable method will in most instances be to obtain permission to accumulate property under subsection 149.1(8) of the *Act*. This is because unlike the accumulation of ten year gifts and bequests of capital, the accumulation of funds under subsection 149.1(8) will, as indicated above, count towards fulfillment of the charity's disbursement quota in each year of the accumulation period.

### **How will the redesignation of a charity impact its disbursement quota?**

Charities are designated as charitable organizations, public foundations or private foundations. As was indicated above, the disbursement quotas are different for these three "types" of charities. The happening of any event that results in a charity being redesignated will therefore alter the disbursement quota of that charity.

A redesignation may be brought about in two ways: (i) The Minister of National Revenue may exercise his discretion under subsection 149.1(6.3) to redesignate a charity; or (ii) The charity may itself request that it be redesignated by submitting a completed Form T2095, *Registered Charities: Application for Redesignation*.

A charity's designation as a charitable organization, public foundation or private foundation is based mainly on the following four variables:

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<sup>33</sup> As indicated above, if the bequest was received prior to 1994 it will *never* be subject to the 80 per cent disbursement quota.

- Source of funding: Charitable organizations and public foundations may not receive more than 50 per cent of their funds from a single person or organization or from a group of people or organizations that do not deal at arm's length. This requirement does not, however, apply to private foundations.
- Disbursement of income. Charitable organizations may not disburse more than 50 per cent of their income to qualified donees. Foundations (both private and public) are not bound by this.
- Composition of board: More than 50 per cent of the trustees, directors, officers or similar officials of charitable organizations and public foundations must deal at arm's length with each other. Private foundations are not bound by this requirement.
- Form of organization. Foundations (both private and public) are required to be in the form of a corporation or trust. Charitable organizations may operate in any form.

A charity must keep these variables in mind so as to avoid inadvertently taking any action that could result in its being redesignated and thereby subjected to a new, potentially more onerous disbursement quota. This could be the case, for example, if a public foundation took any action that could result in its being redesignated as a private foundation. This would result if the public foundation elected board members more than 50 per cent of whom do not deal at arm's length with each other or if it repeatedly accepted very large gifts from a single donor or group of donors that do not deal at arm's length with one another. It should be noted, however, that CCRA has taken the position that it will not redesignate a charity on the basis of it having received a *single* large donation that technically requires the charity to be redesignated.<sup>34</sup>

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<sup>34</sup> James Parks, "New Developments and Challenges with Canada Customs and Revenue Agency" at 5. (Paper presented to Canadian Bar Association of Ontario, Friday, October 27, 2000, Fundamental New Developments in the Law of Charities in Canada).