
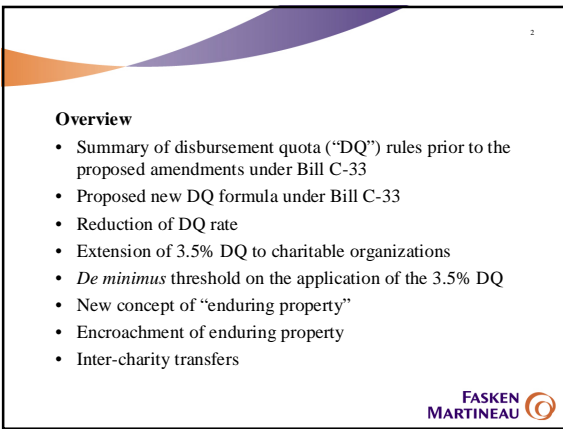


3RD NATIONAL SYMPOSIUM ON CHARITY LAW
NEW DISBURSEMENT QUOTA RULES UNDER BILL C-33
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(current to April 18, 2005)


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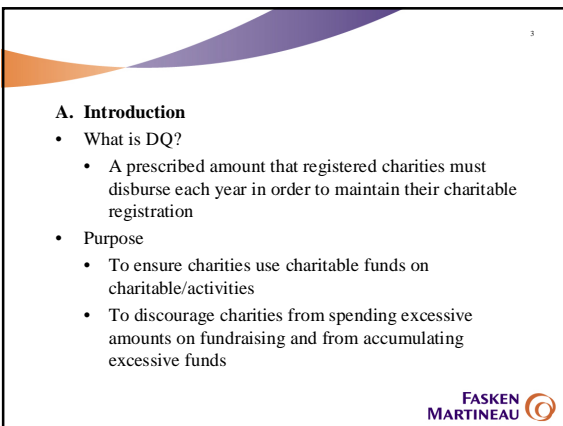


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Overview

- Summary of disbursement quota (“DQ”) rules prior to the proposed amendments under Bill C-33
- Proposed new DQ formula under Bill C-33
- Reduction of DQ rate
- Extension of 3.5% DQ to charitable organizations
- *De minimus* threshold on the application of the 3.5% DQ
- New concept of “enduring property”
- Encroachment of enduring property
- Inter-charity transfers


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A. Introduction

- What is DQ?
 - A prescribed amount that registered charities must disburse each year in order to maintain their charitable registration
- Purpose
 - To ensure charities use charitable funds on charitable/activities
 - To discourage charities from spending excessive amounts on fundraising and from accumulating excessive funds

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- Importance of DQ
 - For charities, donors, advisors
 - Inter-charity transfers
 - Nature of property gifted
 - Nature of restrictions imposed
 - Source of the gift
 - Nature of the proposed recipient charity

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- New DQ rules proposed under Bill C-33
 - March 23, 2004 Federal Budget
 - Draft amendments to the Act - September 16, 2004
 - Further amended - December 6, 2004
 - Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004* - passed by Parliament on February 25, 2005, received first reading by the Senate on March 7, 2005
- Significant revision of the tax rules affecting charities under the Act in the last twenty years and will affect charities for many years to come
- Introduced complicated new DQ rules

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B. DQ rules prior to the proposed amendments

- Changed under Bill C-33
- Charitable organizations
 - Variables A + A.1
 - 80% of receipted donations in preceding year, except:
 - (i) gifts of capital received as bequests or inheritance
 - (ii) ten-year gifts
 - (iii) gifts received from other registered charities
 - 80% of amounts previously excluded under (i) and (ii) but are spent in the year
 - See Table 1 in the paper

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- Public and private foundations
 - $A + A.1 + B + \{C \times 0.045 [D - (E + F)]\} + 365 + G$
 - 80% of received donations in preceding year, except:
 - (i) gifts of capital received as bequests or inheritance
 - (ii) ten-year gifts
 - 80% of amounts previously excluded under (i) and (ii) but are spent in the year
 - 80% of gifts received from other charities, other than specified gifts (100% for private foundations)
 - 4.5% of average value of investment property
 - See Table 1 in the paper

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C. New DQ formula under Bill C-33


- Prior to Bill C-33:
 $A + A.1 + B + \{C \times 0.045 [D - (E + F)]\} + 365 + G$
- September 2004:
 $A + A.1 + A.2 + B + \{C \times 0.035 [D - (E + F)]\} / 365$
- December 2004 / Bill C-33:
 $A + A.1 + B + B.1$
 $B.1 = C \times 0.035 [D - (E + F)] / 365$
- See Table 2 and flow chart at the back of the paper

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D. Reduction of DQ rate


- Currently, public and private foundations are subject to a 4.5% DQ on capital assets not used in charitable activities or administration
- 4.5% DQ reduced to 3.5%
- Based on the current real rate of return minus 20% attributable to administrative costs
- More representative of historical long-term real rates of return earned
- Rate to be reviewed periodically
- Future changes to the rate will require future amendments to the Act
- Applies to taxation years that begin after March 22, 2004

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E. Extension of 3.5% DQ to charitable organizations


- Currently, public and private foundations are subject to a 4.5% DQ
- The reduced 3.5% DQ will also apply to charitable organizations
- Because charitable organizations can also hold capital endowments from which investment income is generated
- For charitable organizations registered after March 22, 2004, the 3.5% DQ will apply to their taxation years that begin after March 22, 2004
- For charitable organizations registered before March 23, 2004, the 3.5% DQ will apply to their taxation years that begin after 2008
- Removed a key difference between charitable organizations and foundations

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F. De minimus threshold on the application of the 3.5% DQ


- 3.5 % DQ only apply to registered charities if they hold investment assets greater than \$25,000
- To provide relief to small charities

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G. New concept of “enduring property”


- New term “enduring property” includes 4 types of property
 - Gifts by way of bequest or inheritance
 - Inter-charity gifts received by an arm’s length charitable organization to be expended in the next 5 years or less on its charitable activities
 - Ten-year gifts
 - Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance

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1. Gifts by way of bequest or inheritance


- Include life insurance proceeds, registered retirement income funds and registered retirement savings plans by way of direct beneficiary designation (to correct a drafting error)
- Applies in respect of deaths after 1998, which retroactivity may lead to hardship for charities that relied on the earlier position of CRA that such direct designations would not be included in the charities' DQ from 2000 to the present
- These gifts will no longer be limited to "gifts of capital received by way of bequests or inheritance", therefore a testamentary income interest received by a charity would be included

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2. Inter-charity gifts received by a charitable organization to be expended in the next 5 years or less in its charitable activities


- Gift received by a charitable organization from another registered charity
- The majority of directors and trustees of the donor charity and donee charity must deal at arm's length
- The gift must be subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years in the course of a program of charitable activities or for the purpose of acquiring a capital property to be used directly in the charitable activities

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3. Ten-year gifts


- Ten-year gifts that are subject to trust or direction that may permit the original recipient charity or a transferee to expend the ten-year gifts before the end of 10 years to the extent permitted under the definition for DQ in order to meet the DQ requirement

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4. Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance


- Gifts by way of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity
- Provided that if the gift is a ten-year gift, the gift is subject to the same terms and conditions under the trust or direction

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H. Encroachment on enduring property

- The December 2004 amendments also introduce the concept of a “capital gains pool”, which in essence consists of the amount of capital gains of a charity resulting from disposition of “enduring property” including a ten year gift
- A charity will now be able to encroach on the capital gains from enduring property, provided that the terms of the gift permit such encroachment, but only up to the lesser of the amount of the 3.5% disbursement quota and the amount in the “capital gains pool”

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- Charities will be able to decide how much to claim within the permitted encroachment limit of the capital gains pool
- But charities will need to track their capital gains pool each year on their T3010A
- Anything above the permitted encroachment limit will be added back into the 80% disbursement quota for the charity and therefore will have limited benefit in meeting the 3.5% disbursement quota

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- Previously, 80% of the disbursement of capital gains from a ten year gift had to be added to the disbursement quota of a charity
- Now, a charity can encroach on the capital gain of a ten year gift, as well as capital gains from other enduring property, up to an amount that is the lesser of the 3.5% disbursement quota and the amount in the “capital gains pool”
- However, the combination of the yearly tracking requirement for the “capital gains pool” and the determination of what is a capital gain will make the calculation of the disbursement quota challenging for charities to comply with

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I. Inter-charity transfers


- Gifts transferred to charitable organizations
- Three categories of property transfers
- How to categorize property transfers
- Transfer as a result of penalty

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1. Gifts transferred to charitable organizations

- Currently, only transfers from registered charities to public and private foundations are subject to the 80% DQ
- i.e. transfers from registered charities to charitable organizations are exempt from the 80% DQ
- Bill C-33 proposes that all transfers from one registered charity to another will be subject to the 80% DQ requirement

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- Gifts of enduring property received from another registered charity will be subject to the same requirements as those that apply to gifts of enduring property received from other persons
- Exception for a “specified gift” will continue to apply
- Apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004

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2. Three categories of property transfers


- Ordinary gifts (i.e. not specified gifts, not enduring property)
- Specified gifts
- Enduring property that has not been designated as specified gifts by the transferor charity

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3. Transfer of ordinary gifts


- i.e., neither specified gifts, nor enduring property
- For the transferor charity, the transfer can be used to satisfy its DQ obligation
- For the transferee charity, there will be an obligation to expend the gift in the following year (because of variable B in DQ formula)
- If the transferee charity is either a charitable organization or a public foundation, the DQ obligation is 80% of the gift

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- If the transferee charity is a private foundation, the DQ obligation is 100% of the gift
- For example: \$100 ordinary gift transferred from Charity A to Charity B


	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	N/A	\$100 expended can be used to satisfy its DQ obligations of Charity A in year 1	<ul style="list-style-type: none"> • Charitable organizations and public foundations have to expend \$80 in year 2 • Private foundations have to expend \$100 in year 2 	N/A

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- When Charity B expends the ordinary gift in the following year, Charity B can use the expenditure to satisfy its DQ obligation in year 2 mentioned above


	Transferee Charity B	
	DQ obligation	DQ satisfaction
Year 2	N/A	The \$ expended can be used to satisfy DQ obligation in year 2

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4. Transfer of specified gifts


- For the transferor charity, the transfer cannot be used to satisfy its DQ obligation (because of 149.1(1.1)(a) exclusion of specified gifts)
- For the transferee charity, there is no obligation to expend the specified gift in the following year (because specified gifts are excluded from A.1 and B of the DQ formula)

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- For example: \$100 specified gift transferred from Charity A to Charity B


	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	N/A	--- Charity A cannot use the \$100 to satisfy its DQ obligation in year 1	--- Charity B is not obligated to expend any of the \$100 in year 2	N/A

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- When Charity B expends the specified gift in a subsequent year, Charity B can use the expenditure to satisfy its DQ obligations in that year


	Transferee Charity B	
	DQ obligation	DQ satisfaction
Subsequent Year	N/A	\$100 expended can be used to satisfy DQ obligations in that year

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5. Transfer of enduring property

- For the transferor charity, there will be a DQ obligation to expend the enduring property in the year (because of variable A.1(a)(ii) of the DQ formula)
- The DQ obligation is met by the transfer itself

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- For the transferee charity, there is no obligation to expend the enduring property in the following year (because enduring property is excluded from B of the DQ formula)
- For example: \$100 enduring property transferred from Charity A to Charity B

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	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	Charity A will be obligated to expend 100% of the fmv of the enduring property in year 1	The DQ obligation created by the transfer is met by the transfer itself	--- no effect on DQ (b/c enduring property is exempt from B in DQ formula)	--- no effect on DQ until Charity B expends the gift

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- When Charity B expends the enduring property in a subsequent year, Charity B will be obligated to expend at least 80% of the enduring property (because of A.1(a)(i) of the DQ formula)
- The DQ obligation for that year would be met by the expenditure of the enduring property

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	Transferee Charity B	
	DQ obligation	DQ satisfaction
Subsequent Year	Charity B will be obligated to expend at least \$80 in the year	The S expended can be used to satisfy DQ obligation in the year

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- However, if Charity A designates the enduring property as a specified gift, then Charity A would not be able to use the expenditure to satisfy its DQ obligation in the year of transfer
 - Charity B would receive the enduring property as a specified gift, which would not create any DQ obligation to expend the specified gift
 - When Charity B expends the gift in a subsequent year, Charity B would be able to use the expenditure to satisfy its other DQ obligations in that year
 - No reason for the transferor charity to agree to transfer the enduring property as a specified gift
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	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	Charity A will be obligated to expend \$100 in year 1	Charity A cannot use the \$100 to satisfy its DQ obligation in year 1 (b/c 149.1(1.1)(a) exclusion of specified gifts)	Charity B is not obligated to expend any of the \$100 in the following year (b/c specified gifts are excluded from A.1 and B of DQ formula)	N/A
Subsequent Year	N/A	N/A	N/A	\$100 expended can be used to satisfy other DQ obligations in that year

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6. Factors to consider in determining how to categorize inter-charity transfers

- Different categories of transfer impact on the DQ obligation and DQ satisfaction of the transferor charity and the transferee charity differently
- Two questions to ask in deciding how to categorize a transfer of assets from one charity to another charity:
 - Question (1) Is the property an enduring property?
 - Question (2) Does the transferor charity require the disbursement to satisfy its DQ obligation for the year and/or DQ shortfall from prior years?

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- If “no” to question (1) and “yes” to question (2):
 - i.e. The property is not an enduring property and the transferor charity requires the disbursement to satisfy its DQ obligation
 - The transferor charity would want to transfer the property as an ordinary gift, not as a specified gift, in order to utilize the transfer to satisfy its DQ obligation
 - The transferee charity would need to include the transfer in its DQ obligation for the following year
 - If the transferor charity transfers the property as a specified gift, the transferor charity cannot use the transfer to satisfy its DQ obligation for the year and the transfer does not create any DQ obligation for the transferee charity

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- If “no” to both questions (1) and (2):
 - It is not an enduring property and the transferor charity does not require the disbursement to satisfy its DQ obligation
 - The transferor charity may choose to transfer the property either as an ordinary gift or as a specified gift
 - If the property is transferred as an ordinary gift, the transfer will lead to a DQ excess for the transferor charity for use in future years. The transferee charity would need to include the transfer in its DQ obligation for the following year
 - If the property is transferred as a specified gift, the transferor charity cannot use the transfer to satisfy its DQ obligation for the year. The transfer would not create any DQ obligation for the transferee charity

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- If “yes” to question (1):
 - i.e. If the property is an enduring property
 - If the transferor charity transfers the enduring property to the transferee charity, the transfer would create a DQ obligation on the transferor charity, which DQ obligation will be satisfied by the transfer itself
 - If the answer to question (2) is “yes,” the transfer would not be of benefit to the transferor charity in relation to the satisfaction of its other DQ obligation because the transfer would be utilized to satisfy the DQ obligation by the transfer itself. The transfer would not affect the DQ obligation of the transferee charity until it is expended

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- If the transferor charity transfers the enduring property as a specified gift, the transfer itself would create a DQ obligation on the transferor charity in the year of the transfer and the transferor charity would not be able to use the transfer itself to satisfy the DQ obligation created by this transfer or any other DQ obligation of the transferor charity (i.e. if the answer to question (2) is “yes”)
- This means that the transferor charity would need to use other expenditure in the year to satisfy both the DQ obligation created by this transfer and its other DQ obligation (undesirable result)
- The transfer does not create any DQ obligation for the transferee charity

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7. Transfer as a result of penalty


- Bill C-33 proposes that a transfer to another registered charity under Part V does not qualify as an expenditure for the purposes of calculating the transferor’s DQ
- Applies in respect of notices of intention to revoke the registration of a charity and to notices of assessment issued by the Minister after the day that is 30 days after Royal Assent

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J. Conclusion

- Attempt by the Department of Finance to address a number of problems facing charities involving DQ
- Very complex new DQ rules - difficult, if not impossible, for the average charity to understand, let alone comply with
- Concerns about removing key differences between charitable organizations and public foundations

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