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What Do the New Disbursement Quota Rules Mean for Your Church or Charity?

(Powerpoint Presentation)

**By M. Elan Hoffstein, B.A., M.A., LL.B.
And Theresa L.M. Man, B.Sc., M.Mus., LL.B.**

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BARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with Fasken Martineau DuMoulin LLP

Offices / Bureaux
Orangeville (519) 942-0001
Ottawa (613) 212-2213
Toll Free / San frais:
1-877-942-0001

www.carters.ca 

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OVERVIEW

- New DQ formula enacted on May 13, 2005
 - The 4.5% disbursement quota is reduced to 3.5%
 - The 3.5% disbursement quota is extended to charitable organizations
 - Inter-charity transfers to charitable organizations are now subject to the 80% disbursement quota
 - The 80% disbursement quota can be delayed through utilizing “enduring property” including ten year gifts
 - Inter-charity transfers have become complicated

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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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DQ RULES PRIOR TO THE PROPOSED AMENDMENTS

Charitable organizations

- 80% of receipted donations in preceding year, except:
 - i. gifts of capital received as bequest or inheritance
 - ii. ten-year gifts
 - iii. gifts received from other registered charities
- 80% of amounts previously excluded under (i) and (ii) but which are spent in the year

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PUBLIC AND PRIVATE FOUNDATIONS

- 80% of receipted donations in preceding year, except:
 - i. gifts of capital received as bequest or inheritance
 - ii. ten-year gifts
- 80% of amounts previously excluded under (i) and (ii) but which 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

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NEW DQ FORMULA

- 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:

$$A + A.1 + B + B.1$$

$$B.1 = C \times 0.035 [D - (E + F)] / 365$$

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NEW FORMULA $A + A.1 + B + B.1$

- $A = 80\%$ of prior year receipted donations (excluding enduring property and gifts from other charities)
- $A.1 =$ amount by which
 - a) sum of
 - (i) 80% enduring property expended in year (except for specified gift, pre-1994 bequests or inheritances and property described in (ii) plus
 - (ii) total enduring property gifts transferred to qualified donees (except specified gift)
 - Exceeds
 - b) amount claimed by charity that may not exceed lesser of 3.5% of investment assets and capital gains pool for year

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- $B = 100\%$ of gifts from other charities if private foundation and 80% if charitable organization or public foundation (except specified gifts and enduring property)
- $B.1 = \frac{C \times .035 [D - (E + F)]}{365}$
- (3.5% of capital is the “D” amount, and D must be greater than \$25,000)

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REDUCTION OF DQ RATE

- Public and private foundations had been 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
- Applies to taxation years that begin after March 22, 2004

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EXTENSION OF 3.5% DQ TO CHARITABLE ORGANIZATIONS

- Only public and private foundations had been subject to the 4.5% DQ
- The reduced 3.5% DQ will now apply to charitable organizations as well
- 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
- Removes a key difference between charitable organizations and foundations

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DE MINIMUS THRESHOLD ON THE APPLICATION OF THE 3.5% DQ

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

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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

- Where an individual has designated a charity as a direct beneficiary of an RRSP, RRIF or life insurance policy, the May 2005 amendments treat such gifts as enduring property for the purposes of the disbursement quota rules
- This will mean that direct designation of RRSP, RRIF and life insurance proceeds will be subject only to the 3.5% disbursement quota while they are held as capital and then subject to the 80% disbursement quota in the year in which they are disbursed

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- 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
- 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

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- More than 50% of the directors of the donor deal at arm's length with each director of the donee charitable organization
- The gift must be subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years
 - (i) in the course of a program of charitable activities that could not reasonably be completed in the first year
 - (ii) for the purpose of acquiring a capital property of the charitable organization to be used directly in its charitable activities or administration

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3. Ten-year gifts

- 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 (but not 5-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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ENCROACHMENT ON ENDURING PROPERTY

- New concept introduced of a “capital gains pool”, which is a notional account to keep track of the amount of capital gains realized by a charity from the disposition of “enduring property”
- Charities are now 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 need to decide how much to claim within the permitted encroachment limit of the capital gains pool
- Charities should 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
- 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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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
 - Previously, 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
 - Now, all transfers of funds from one registered charity to another, including transfers to a charitable organization (but excluding transfers of enduring property) will be subject to the 80% disbursement obligation, i.e. 80% of the gift must be expended in the following taxation year
 - Exception for a “specified gift” will continue to apply

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- Apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004
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
- For the transferee charity, there is no obligation to expend the specified gift in the following year

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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

- The following rules do not apply to enduring property received as specified gifts
- For the transferor charity, there will be a DQ obligation to expend the enduring property in the year
- The DQ obligation is met by the transfer itself
- For the transferee charity, there is no obligation to expend the enduring property in the following year
- 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
- The DQ obligation for that year would be met by the expenditure of the enduring property

	Transferee Charity B	
	DQ obligation	DQ satisfaction
Subsequent Year	Charity B will be obligated to expend at least \$80 in the year	The \$ 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
- Limited reasons 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	Charity B is not obligated to expend any of the \$100 in the following year	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. Transfer as a result of penalty

- 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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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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