
Advisory Committee to the Charitable Sector (ACCS) Submission to Finance Canada on Disbursement Quota Reform August 31, 2021

The following Submission is posted in accordance with permission from the Advisory Committee to the Charitable Sector (“ACCS”).

CARTERS

Carters Professional Corporation / Société professionnelle Carters
Barristers · Solicitors · Trade-mark Agents / Avocats et agents de marques de commerce
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

Toronto · Ottawa
Orangeville
Toll Free: 1-877-942-0001

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

August 31, 2021

Re: Charities Consultation on the Disbursement Quota

This submission to the Tax Policy Branch of Finance Canada is presented on behalf of the 14 sector members of the Advisory Committee on the Charitable Sector active until August 31, 2021. The sector members unanimously approved the contents of this submission. We hope that this submission will help to inform the policy conversation on a modernized legislative and regulatory framework for charities in Canada.

The ACCS sector co-chairs, Bruce MacDonald and Hilary Pearson, would be pleased to provide any additional information.

Signed,

Bruce MacDonald

President & CEO, Imagine Canada

Hilary Pearson

Former President, Philanthropic Foundations Canada

Andrea McManus – *Chair and Founding Partner of ViTreo Group*

Paula Speevak – *President & CEO Volunteer Canada*

Arlene MacDonald – *Former executive Director of Community Sector Council of Nova Scotia*

Paulette Senior – *President & CEO of Canadian Women's Foundation*

Bruce Lawson – *President & CEO of The Counselling Foundation of Canada*

Peter Dinsdale – *President & CEO of YMCA Canada*

Denise Byrnes – *Executive Director of OXFAM-Québec*

Peter Elson – *Adjunct Assistant Professor, University of Victoria*

Kevin McCort – *President & CEO of Vancouver Foundation*

Peter Robinson – *Co-Owner of Hedgerow Farm and Former CEO of David Suzuki Foundation*

Susan Manwaring – *Partner, Miller Thomson*

Terrance Carter – *Partner, Carters Professional Corporation*

August 31, 2021

Submission made to Finance Canada by the Advisory Committee on the Charitable Sector*

The Charitable Sector and the Disbursement Quota

As we move toward what we hope is the end of the pandemic crisis, there are calls for government to address the financial challenges faced by non-profit organizations through facilitating increased access to funding, whether from grants or donations. Charities and non-profits serving vulnerable populations are particularly poorly funded and this has been the case since well before the pandemic. They have been even more deeply impacted over the last year and a half; stressed by increased demand on their services and by difficulties in accessing donations.

In this context, it has been suggested that one route to increase charitable donations is an increase in the annual disbursement quota applied to registered charities (including charitable foundations). The Department of Finance Canada has launched a consultation on the disbursement quota under the heading: “Boosting charitable spending in our communities”. The Advisory Committee on the Charitable Sector (ACCS) has been asked by Finance Canada to provide its input into the consultation process. **This submission is made in response to that request.**

The Disbursement Quota (DQ) is the minimum amount (3.5%) a registered charity is required to spend from the assets that it does not otherwise use for charitable activities or administration (i.e., investment assets). This quota can be met by spending on its own charitable activities or through gifts to qualified donees (for example, other registered charities). The policy purpose of the DQ is to discourage charities from accumulating excess capital and to ensure that there is no undue delay in disbursing those assets on charitable purposes and activities.

The first sentence of the consultation document released by Finance Canada states that: “supporting Canada’s charities, non-profits, social enterprises, and other organizations to provide vital services to our communities, including to the most vulnerable members of society, is a key priority of the federal government.” **The ACCS agrees with the goal of supporting organizations who are providing service to the most vulnerable. However, the DQ is but *one* tool in the policy toolbox. We do not believe that there is clear evidence that raising the disbursement quota alone, without making other legislative changes and using other policy tools, will achieve that goal.**

Many organizations serving the most vulnerable populations are not qualified donees. During our consultations over the last year, ACCS members heard that many organizations serving vulnerable populations (including those serving or led by vulnerable women, Indigenous peoples, Black people and people of colour) are small and grassroots-based, and do not have the capacity to apply for and maintain qualified donee status. These organizations also indicated that current policies perpetuate colonial and paternalistic approaches. And, unless the organizations working with the most vulnerable can work with an intermediary, under the current “direction and control” regulatory regime, they are generally unable to access donations from registered charities.

*This submission was approved by the 14 sector members of the ACCS serving before August 31, 2021. See final page for names of the ACCS sector members.

Indeed, we heard from stakeholders that the federal government's Emergency Community Support Fund, administered by Community Foundations of Canada, United Way/Centraide Canada and the Canadian Red Cross in the first year of the pandemic, was available only to qualified donees or those organizations that could access a financial intermediary to flow funds. This meant that the emergency grants may not have delivered support to some of the most vulnerable members of society where it was most needed

The ACCS has made several recommendations in its first three reports to the Minister of National Revenue that would make it easier for charities to work with non-qualified donees. These include:

- Removal of "own activities" provision in the *Income Tax Act*, to permit more flexibility in the regulatory regime and change the "direction and control" requirements now imposed on charities and their non-charity partners (ACCS report # 1)
- With respect to working with Indigenous Peoples, communities and Indigenous-led organizations: defining Reconciliation as being beneficial to the community under the fourth head of charity and making it easier to obtain QD status as municipal or public bodies performing the function of government (ACCS report # 2)
- With respect to racialized and vulnerable populations: expand the category of qualified donees to enable non-profit organizations to receive grants without becoming registered charities; currently, many smaller grassroots organizations apply for charitable status primarily to access funds from granting foundations and government; eliminating this requirement would permit smaller non-profit organizations to avoid the expensive and time-consuming process of obtaining and maintaining charitable status. (ACCS report # 3)

The DQ policy is not a mechanism to increase distribution of resources to vulnerable populations or to organizations hard hit by COVID. The policy ensures that charitable assets are either used in direct charitable programming or in making grants to other registered charities or qualified donees. Public policy does not direct which registered charities or qualified donees are to receive the funds, nor should it. Within the grantmaking sector itself, one important change would be to increase diversity and representation in decision-making, given that most foundations, according to a recent Statistics Canada survey on diversity in the sector, are white-led and do not have representation on their boards or granting committees, nor connections to equity-seeking and vulnerable populations.

The ACCS supports public policies that ensure more equitable and effective access to grants and contributions by registered charities. The disbursement quota alone is not the mechanism for this purpose. Our discussion, therefore, centers not on the amount of funding distributed but on the effectiveness of the policy in ensuring that funds are distributed without undue delay. We have examined issues of rate calculation, application, reporting, compliance, and other policy considerations, as well as issues of data collection and accuracy.

Issues with the Disbursement Quota

To understand how the DQ policy is performing its policy purposes, we looked for data in the T3010 Charity Return form which provides the most comprehensive administrative and financial data on Canada's charitable sector.

The Disbursement Quota sets a minimum requirement that the registered charity must spend of 3.5% of their investment assets. This is calculated on a 24-month average value of these assets for the two years preceding the taxation year in which the charity is reporting.

T3010 data indicates that charitable organizations who are not foundations typically do not accumulate capital or reserves but rather spend most of or all their resources on charitable activities and administration. Organizations led by or serving vulnerable populations (Indigenous, Black, and Women serving for example) report the lowest number of assets. The Disbursement Quota is, therefore, as a policy most relevant to private and public foundations because they hold the bulk of the sector's investment assets.

Findings:

The ACCS looked at data available related to accumulated assets, disbursement, issues of the rate, and examined the application of the DQ policy on assets.

How effective is its application to ensure excessive assets are not accumulated? The T3010 can provide information on the total assets held by private and public foundations. The ACCS looked at 2018 data. The 2019 data confirm that assets have continued to increase.

For 2018, 9,536 private and public foundations in Canada reported (through their annual T3010 reports) a total of \$89 billion+ in total assets. Some of the funds included in the \$89B are funds which are being double counted as foundations also grant to other foundations. It is important to acknowledge this fact and to adjust (decrease) this total to reflect the actual unique assets held in the sector.

Assets held by foundations have continued to increase year over year - this is true. It is also true that the increase is a function both of investment returns and as a function of an increase in the number of foundations created, particularly since 2008. But most charitable foundations invest conservatively and are unlikely to have benefited from the highest risk/highest returns available over the period.

Particularly relevant to this issue is the fact that 50.2% of the total \$89 Billion in assets are held by less than half of 1% of registered charitable foundations in Canada (according to 2018 T3010 data). The accumulation of assets in 'the sector' is not a widespread phenomenon. Many of these foundations are public foundations which grant specifically to a designated hospital, a university, or a religious organization, and several are community foundations.

How effective is its application to ensure assets are disbursed without undue delay? Based on an analysis of T3010 data, on average, foundations are disbursing above 6% of invested assets on charitable activities and grants, particularly when the numbers are adjusted to account for extreme outliers (organizations whose numbers skew the story for the rest of the sector).

While in aggregate the sector is disbursing above the DQ requirement, there is a clustering of organizations spending at the 3.5% level. There are also some who do not meet the DQ each year. While data can provide numbers, it does not answer why some organizations are funding at the minimum or why some organizations are not meeting their DQ. It is unclear if charities clustered at

3.5% are interpreting the DQ rate as a ceiling instead of a minimum. Also, the rules permit a charity to carry forward a DQ excess up to 5 years or back up to one year so failure to satisfy a DQ number in any one year does not necessarily mean non-compliance.

Further It is our understanding that the CRA generally does not audit charities only for the purpose of discovering non-compliance with the DQ. While Finance Canada has asked *what* additional tools should be available to CRA to enforce the disbursement quota rules, the ACCS questions *whether* additional tools are needed. The current CRA compliance regime is described on the [CRA website](#) as follows:

*We approach compliance through **education first**. We have several tools at our disposal:*

- *Website*
- *Outreach program*
- *Client service program*
- *Reminder letters*
- *Audit program*

The ACCS supports this “education first” approach and believes the current tools are sufficient assuming they are currently being used to audit compliance with the DQ provisions. The current Intermediate sanctions are used to deter actions by a charity that are clearly offside the regulatory provisions. Compliance with the DQ provisions is complicated and requires consideration of many factors. The ACCS believes a better approach than a sanction is for CRA to require the registered charity to address the DQ shortfall.

The ACCS believes that an intermediate sanction for one time failure to comply with the DQ obligation is unnecessary as compliance agreements (a tool in the current toolbox) could be used to require a charity to eliminate its shortfall which is the desired result.

If a sanction or penalty was to be considered it should only apply for situations where the registered charity has previously signed a compliance agreement in which it committed to bringing itself into compliance by eliminating its shortfall and has repeatedly failed to do so.

If a sanction is proposed for repeat offenders, the ACCS supports a provision like the existing intermediate sanctions that provides for payment of a penalty imposed to be satisfied by the registered charity making a grant to an Eligible Donee (another registered charity that operates at arm’s length from the charity paying the penalty).

While noncompliance may contribute to the accumulation of assets and to the delay in disbursement, most of the sector is compliant. There is no evidence that non-compliance is a significant problem. It is however clear from the review of the data set that mistakes are common and that the calculation of the Disbursement Quota is complex.

Accuracy in calculating the rate and in reporting is a concern. Entry errors occur frequently in financial reporting fields of the T3010 (for example leaving fields blank or adding too many/not enough digits).

Many foundations do not complete a value for Line 5900 in the form, which is meant to report the value of assets not used in charitable activities for the previous 24 months. This means that an accurate DQ calculation is impossible. Most of the sector still submits paper tax returns, which are manually inputted, leaving room for human keystroke error.

The policy behind how the DQ rate is set is not clear. Pre-2004, the DQ rate was set at 4.5%, and some charities struggled to meet the 4.5% requirement due to the low investment yields at the time. The 2004 Budget stated that the 3.5% figure was intended to be “more representative of historical long-term real rates of return earned on the typical investment portfolio held by a registered charity.” The 2004 Budget also indicated that the rate was to be reviewed periodically to ensure that it continued to be representative of long-term rates of return. It has been 17 years since the rate has been adjusted.

We also cannot tell from the T3010 data *why* in some situations the assets that are currently accumulated are not being dispersed. It is possible that assets are restricted from disbursement by donor direction. However, without more information, it is difficult to determine the amount of restricted assets and when they would be available for granting.

The DQ applies to the total assets of the foundation not otherwise used for charitable activities or administration; it is not applied fund by fund. Therefore, it is possible that there are some donor advised funds (DAFs) not disbursing at all during a given year. Depending on its size, a foundation can meet its DQ by making disbursements from only some of the DAFs or other investment assets that it holds. Public foundations could address this by proactively advising the DAF donors if no disbursements are being made and acting to make those disbursements with or without donor advice. This proactive education approach was taken recently by the Vancouver Foundation.

Further, the T3010 form does not ask a charity to identify when it is making use of carry forward provisions. It is difficult therefore to determine if the use of carry-forward provisions is a significant contributor to the accumulation of assets in the sector or to a delay in disbursement. There are also provisions that permit the accumulation of property in certain scenarios if the Minister of National Revenue agrees. The impact of the use of the accumulation of property provisions is unclear. The Charities Directorate receives requests for permission to accumulate for various reasons, however, according to CRA requests to reduce disbursement quota are rare from charities, including foundations.

Finally, investment in the sector is happening in new and innovative ways. Impact investments, social enterprise, crowdfunding, social finance bonds, and other instruments are changing the asset map of the sector. Some foundations are making Program-Related Investments (PRIs), which directly contribute to the charitable purposes and financial stability of charities, but which the CRA does not permit the investor charity to include in meeting its DQ. On the specific issue of encroachment, the ACCS notes that the management of charities' investments, and indeed the constitutional power over charities, is held by the provinces. If an increase was implemented this would have to be considered, as would trust law provisions that prohibit encroachment on capital unless authorized by the donor or the court.

Recommendations

A simplification of the explanations provided in the CRA guidance on completing the T3010 form would assist charities in filling out their asset value more accurately.

Increased education for accountants and professional advisors who are filling out the T3010 form on behalf of clients would also greatly help in the accurate calculation of the DQ. This education could be done by the CRA itself and by sector intermediary and umbrella organizations representing foundations and other charities, in a collaborative educational outreach program with the CRA.

CRA should move more rapidly to implement and encourage use of the digital T3010 form. This would help to catch errors earlier, assuming the digital form will be structured to ensure proper fields are completed and/or totals are properly added before submission can occur. Consideration could be given by the CRA to make it mandatory to fill in Lines 5900 or 5910, **even** on the paper form.

A regular schedule for a DQ rate review would make it easier to adjust, as well as be more predictable for charities. A consistent, transparent formula to establish the DQ rate would facilitate rate adjustment. The ACCS believes that more consultation on this question would be needed before implementing any type of formula in this area.

Filling gaps in data would facilitate evidence-based decision making on the DQ policy. The T3010 sections on financial data could be made more detailed, including more detailed questions on investments. This would provide considerably more information on which to base any assessment of whether capital is being accumulated excessively and whether assets are being disbursed at a rate that is sustainable. The ACCS acknowledges that charities have often asked for simplification of the form. We believe however that this lack of information is a challenge for the federal government in developing policy revisions.

As the ACCS recommended in its previous reports, the Government could partner with intermediaries to fill data gaps more quickly.

A change in CRA administrative position to include PRIs and other forms of dual-purpose investments used by a charity to achieve its charitable purpose as a charitable disbursement or expenditure for purposes of meeting its DQ would be helpful, since these “investments” constitute a growing form of disbursement for charitable purposes. Including PRIs would provide a more accurate picture of how assets are being deployed for charitable purposes and may also act as an incentive to do more with respect to impact investing.

DAFs are a growing pool of philanthropic assets. The DQ is not applied fund by fund. The ACCS believes that more study and consultation is required to understand the growth of DAFs and whether delays in disbursement from individual funds contributes to the perception that there is an accumulation of assets/delay in granting. Since many public foundations hold multiple DAFs, consideration should be given in this review to the administrative and technical issues involved if a DQ were to be applied fund by fund, to avoid unintended administrative burdens for charities.

We also wish to return attention to the recommendations made in previous ACCS reports around the removal of the “own activities” provision in the Income Tax Act, which created the “direction and control” regime, as well as making it easier to become a qualified donee status and/or allowing non-qualified donees to receive grants as necessary and complementary tools in the toolbox to help ensure that organizations serving vulnerable and underserved members of society are eligible to benefit from charitable donations.

Conclusion

Significant gaps in data make it difficult to support a change in the disbursement quota policy, whether temporary or long-term. There is no clear evidence that an increase would boost charitable spending to “support Canada’s charities, non-profits, social enterprises, and other organizations to provide vital services to our communities, including to the most vulnerable members of society”. The DQ, as already stated, does not regulate the types of organizations or communities to which funds are granted, so in the absence of other policy reforms previously recommended by the ACCS, an increase would be ineffective in delivering increased support to vulnerable members of society.

A simple application of assets multiplied by rate does not generate a predictable and certain result. When data inaccuracies and gaps are so widespread, we cannot confirm what percentage of assets accumulated in the sector would be triggered by a rate increase and which assets would continue to be excluded from disbursement. Foundations on average are already disbursing above 6.8%, if a rate increase was the only policy or lever deployed, a rate would have to be set above this average for a substantive increase in grants to happen. It is important to recognize that much of the sector reports increased demand at the same time reporting challenges in maintaining their workforce; the capacity of Foundations to rapidly increase their granting processes would have to be considered, especially if the expectation is rapid relief and recovery.

The DQ policy is intended to ensure that the sector’s funds are spent on charitable purposes; in considering amendments to the DQ policy it is important to consider the consequences of amendments to the policy on the sector’s flexibility and capacity to have impact. Several unintended consequences could result, including financial instability and legal difficulties for registered charities under donor and/or trust law restrictions, and increased reluctance to make donations through private foundations, which will diminish the value and contribution of endowed foundations as long-term investors and donors. Another consequence may be that public foundations may have more difficulty appealing to donors for endowed gifts since the DQ rate may not make it possible to preserve or grow the value of the donated assets.

Some established charities, such as hospitals, universities and colleges and religious institutions may benefit from additional funding with a higher DQ. But the underfunded charities, the charities working on long-term systemic policy changes and the organizations that cannot or do not want charitable status will not be guaranteed to benefit.

The ACCS does not think that it would be desirable to force charities to encroach on investment capital. There is a strong argument to be made for maintaining the value over time of this capital, which is then available for ongoing regular disbursements. This affords continuity of philanthropic giving, and the

ability for charities to give sustainably and reliably to bring about outcomes that may only be realizable in the very long term. This is of value to the whole sector. Some examples of these philanthropic long-term investments are longitudinal research studies, or experiments in designing and testing new social programming, or support for policy development studies, or core support to build networks and collective impact backbone organizations that require investment for years before generating optimal social benefit. Our country's most complex challenges, such as developing solutions to addiction, homelessness, adaptation to climate change, and generational poverty, require a long-time horizon and much patient philanthropic capital. While the ACCS acknowledges the importance of making regular disbursements on a yearly basis and agrees with the goal of encouraging charities to grant as much as possible to today's urgent needs, we also believe that it is good public policy to encourage many charities to take a long-term view.

Would granting behaviour change for the better if there were more clarity around the DQ calculation? Would it be more likely that charities would meet the DQ or more accurately report their finances? We believe this is likely, as foundations and donors will understand more clearly what they could disburse and would be able to frame their investment and disbursement policies more effectively. More education of donors to remove or not to impose restrictions on the encroachment of capital and to increase their spend could also contribute to an increase in grants. While donor behaviour may need to change, in our view, it is not an advisable solution for the government to enter the area of regulating the destination or direction of grants to specific communities and causes.

At the end of the day, what the charitable and non-profit sector needs is stable core funding. Unfortunately, the 'charity mindset', which views charities from the perspective of scarcity and not of abundance contributes to the chronic underfunding of the sector and the instability of its workforce, undermining the sector's capacity for effectiveness and impact. Canada relies on this sector; we look to it to respond to the current and pressing needs of affordable housing, food insecurity, and childcare while at the same time we expect it to continue searching for a cure for cancer, to build our next gold medal team, and to address climate change. Policy must find a way to balance the sector's current needs to respond with flexibility and urgency to today's demands with the need for sustained and committed long-term funding for the future of communities within Canada and around the world. The Disbursement Quota policy is one tool but alone it is not enough to gain the federal government's key policy objective of "supporting Canada's charities, non-profits, social enterprises, and other organizations to provide vital services to our communities, including to the most vulnerable members of society." The ACCS recommends a considered review of the whole regulatory and policy framework for the sector to ensure that this policy goal is achieved.

Sector Members of the Advisory Committee on the Charitable Sector (as of August 31, 2021)

Bruce MacDonald

President & CEO, Imagine Canada

Andrea McManus – *Chair and Founding Partner of ViTreo Group*

Arlene MacDonald – *Former executive Director of Community Sector Council of Nova Scotia*

Bruce Lawson – *President & CEO of The Counselling Foundation of Canada*

Denise Byrnes – *Executive Director of OXFAM-Québec*

Kevin McCort – *President & CEO of Vancouver Foundation*

Hilary Pearson

Former President, Philanthropic Foundations Canada

Paula Speevak – *President & CEO Volunteer Canada*

Paulette Senior – *President & CEO of Canadian Women's Foundation*

Peter Dinsdale – *President & CEO of YMCA Canada*

Peter Elson – *Adjunct Assistant Professor, University of Victoria*

Peter Robinson – *Co-Owner of Hedgerow Farm and Former CEO of David Suzuki Foundation*

Susan Manwaring – *Partner, Miller Thomson*

Terrance Carter – *Partner, Carters Professional Corporation*