

NEW DISBURSEMENT QUOTA RULES IN SEPTEMBER 16, 2004 DRAFT AMENDMENTS TO THE *INCOME TAX ACT*

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A. INTRODUCTION

This is the last in a series of four *Charity Law Bulletins* commenting on the draft amendments to the *Income Tax Act* (the “Act”) released by the Department of Finance on September 16, 2004 (the “September 2004 Amendments”) that, when adopted, will implement the initiative of the Federal Government in rewriting the tax rules concerning the taxation and administration of charities as set out in the Federal Budget that was announced on March 23, 2004 (the “2004 Budget”). Details regarding the 2004 Budget are summarized in *Charity Law Bulletin* No. 41.¹ This *Charity Law Bulletin* summarizes changes to the Act proposed in the September 2004 Amendments in relation to new disbursement quota rules that apply to registered charities. Other amendments to the Act proposed in the September 2004 Amendments regarding intermediate taxes and penalties, revocation and annulment of registered charities, new appeal regime for charities, and increased transparency and accessibility of information from Canada Revenue Agency (“CRA”) regarding charities have been summarized in the first three *Charity Law Bulletins* in this series.²

As indicated in *Charity Law Bulletin* No. 54 dated October 29, 2004, it is important to note that the

¹ *Charity Law Bulletin* No. 41 dated March 30, 2004 is available on our website at www.charitylaw.ca.

² See *Charity Law Bulletin* No. 54 dated October 29, 2004, *Charity Law Bulletin* No. 55 dated October 30, 2004, and *Charity Law Bulletin* No. 56 dated October 31, 2004, all of which are available on our website at www.charitylaw.ca.

proposals that are set out in the 2004 Budget should be read in addition to the February 27, 2004 revised draft technical amendments, which were commented on in *Charity Law Bulletin* No. 40,³ as well as in a paper by the authors entitled “Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts (current to March 1, 2004).”⁴

B. SUMMARY OF THE DISBURSEMENT QUOTA RULES PRIOR TO THE PROPOSED AMENDMENTS

Before examining the new disbursement quota rules proposed in the September 2004 Amendments, it is first necessary to review the disbursement quota rules that are in place prior to the proposed amendments. The purpose of disbursement quota is “to ensure that most of a charity’s funds are used to further its charitable purposes and activities; to discourage charities from accumulating excessive funds; and to keep other expenses at a reasonable level.”⁵ The disbursement quota for charitable organizations, public foundations and private foundations are different.⁶ Disbursement quota is defined in paragraph 149.1(1) of the Act.⁷

1. Charitable organizations

Prior to the proposed amendments, the disbursement quota for a charitable organization is the total of two figures, i.e. variables “A” and “A.1”, used in an algebraic formula contained in subsection 149.1(1) of the Act. Variable “A” is defined as 80% of the total of all amounts each of which the charity issued a donation receipt in its immediately preceding taxation year, other than the following:

- (a) a gift of capital received by way of bequest or inheritance;
- (b) a gift received subject to a trust or direction to the effect that the property given, or property substituted therefor, is to be held by the charity for a period of not less than 10 years (this is commonly known as “ten-year gifts”); and
- (c) a gift received from another registered charity.

³ *Charity Law Bulletin* No. 40 dated March 29, 2004 is available on our website at www.charitylaw.ca.

⁴ The paper “Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts (current to March 1, 2004)” was presented to the Society of Estate and Trust Practitioners on March 4, 2004 is available on our website at www.charitylaw.ca.

⁵ See Information Circular RC 4108, *Registered Charities and the Income Tax Act*, updated May 7, 2002.

⁶ For a discussion on the new definitions for charitable organizations, public foundations and private foundations proposed by draft amendments to the Act introduced on December 20, 2002 and consolidated in draft amendments to the Act introduced on February 27, 2004, please see *Charity Law Bulletin* No. 21 dated April 30, 2003 and *Charity Law Bulletin* No. 40 dated March 29, 2004.

⁷ Although the definition for disbursement quota in paragraph 149.1(1) only makes reference to charitable foundations, this definition in effect also applies to charitable organizations – See paragraph 149.1(2)(b) and definition for “disbursement excess” in subsection 149.1(21) of the Act.

Variable “A.1” is defined to be 80% of the amounts that are (1) gifts of (i) capital received by way of bequests or inheritance for taxation years that begin after 1993 and (ii) ten-year gifts whenever they were received, (2) have previously been excluded from the charity’s disbursement quota when calculating variable “A” above, and (3) are spent by the charity in the year.

2. Public foundations

Prior to the proposed amendments, the disbursement quota for a public foundation is set out in the following formula:

$$A + A.1 + B + \{C \times 0.045 [D - (E + F)]\} \div 365 + G$$

In other words, the disbursement quota for a public foundation is the total of the following amounts:

- ◆ Variables “A” and “A.1” are the same as above in relation to disbursement quota for charitable organizations.
- ◆ Variable “B” is 80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts.⁸
- ◆ 4.5% of variable “D”, having first deducted variables “E” and “F” from “D” (where variable “C” in the formula is the number of days in the taxation year).
 - Variable “D” is the average value (i.e. the “prescribed amount”) of assets of the public foundation in the immediately preceding 24 months that was not used directly in charitable activities or administration of the foundation. Sections 3700 to 3702 of the *Income Tax Regulations* provide a detailed mechanism to calculate the “prescribed amount” for purposes of calculating “D”.
 - Variable “E” is 5/4 of the total of “A” and “A.1” for the year, i.e. 100% of the amounts included when calculating “A” and “A.1” referred to above, rather than 80%.
 - Variable “F” is 5/4 of “B”, i.e. 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gift.

⁸Summary Policy CSP – S12 dated September 3, 2003 indicates that a specified gift is “a gift from one registered charity to another, where the charities involved choose to make the transfer without affecting the disbursement quota of either charity.” A gift becomes a specified gift if the transferor charity identifies it as such in its information return for the year. Information Circular RC 4108, entitled *Registered Charities and the Income Tax Act*, explains that the transferor charity cannot use a specified gift to satisfy its own disbursement quota. If the recipient charity is a charitable foundation, specified gifts received would not increase its disbursement quota. If the recipient charity is a charitable organization, it would not benefit from receiving a specified gift because it does not have to include gifts received from other registered charities.

Variable “G” refers to a defined amount in the first 10 taxation years of a public foundation commencing after 1983, and therefore is no longer relevant today.

3. Private foundations

For a private foundation, the disbursement quota is the same as that for a public foundation, except:

- ◆ When calculating variable “B”, 100% of all amounts received from a registered charity in its immediately preceding taxation year are included in the disbursement quota, rather than 80%.
- ◆ Variable “F” is the same as variable “B” (i.e. 100% of all amounts received from other registered charities in its immediately preceding taxation year), rather than 5/4 of “B” because 100% of the amounts has already been taken into account when calculating variable “B”.

4. Summary

The following table summarizes the disbursement quota rules that are in place prior to the proposed September 2004 Amendments:

Registered Charities	Disbursement Quota = A + A.1 + B + {C x 0.045 [D – (E + F)]} ÷ 365 + G			
	“A”	“A.1”	“B”	{C x 4.5% [D – (E + F)]} ÷ 365
Charitable Organizations	80% of the all amounts each of which the charity issued a donation receipt in its immediately preceding taxation year, other than: (a) a gift of capital received by way of bequest or inheritance; (b) a ten-year gift; and (c) a gift received from another registered charity	80% of the amounts that are (1) gifts of (i) capital received by way of bequests or inheritance for taxation years that begin after 1993 and (ii) ten-year gifts whenever received, (2) have previously been excluded from the charity’s disbursement quota when calculating “A”, and (3) are spent by the charity in the year	N/A	N/A
Public Foundations	same as above	same as above	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts	4.5% of [“D” - “E” - “F”] ◆ “D” = average value of assets of the foundation in the immediately preceding 24 months that were not used directly in charitable activities or administration of the foundation ◆ “E” = 5/4 of (“A” + “A.1”) = 100% of (“A” + “A.1”) ◆ “F” = 5/4 of “B” = 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gift
Private Foundations	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that “F” = “B”, not 5/4 of “B”

C. PROPOSED NEW DISBURSEMENT QUOTA RULES

The following new algebraic formula for disbursement quota is introduced by the September 2004 Amendments:

$$A + A.1 + A.2 + B + \{C \times 0.035 [D - (E + F)]\} \div 365$$

The changes include the following:

- ◆ Variables “A”, “A.1”, “B”, “D”, “E”, and “F” have been redefined;
- ◆ New variable “A.2” has been introduced;
- ◆ 4.5% disbursement quota has been reduced to 3.5%; and
- ◆ New concepts of “enduring property” and capital gains pool” have been introduced.

The implications of the above changes are commented upon below.

D. REDUCTION OF DISBURSEMENT QUOTA RATE

The September 2004 Amendments propose to reduce the 4.5% disbursement quota that applies to public and private foundations to a more manageable rate of 3.5%. Apparently, the formula that is used by the Department of Finance for the September 2004 Amendments is based on the current real rate of return minus 20% attributable to administrative costs. The 2004 Budget indicates that the rate is to be reviewed periodically to ensure that it continues to be representative of long-term rates of return. However, this flexibility has not been built into the new disbursement quota formula in the Act. This would mean that changes in the economy in future that may again lead to the impracticality of the 3.5% disbursement would necessitate future amendments to the Act. In the event that a registered charity is not able to meet the reduced 3.5% disbursement quota, it can still apply for dispensation to reduce the disbursement quota in accordance with subsection 149.1(5) of the Act. The reduction of the 4.5% disbursement quota to 3.5% applies to taxation years that begin after March 22, 2004.

E. EXTENSION OF 3.5% DISBURSEMENT QUOTA TO CHARITABLE ORGANIZATIONS

Prior to the proposed amendments, only public and private foundations are subject to a disbursement quota upon its capital assets not used in charitable activities or administration. However, the September 2004 Amendments propose that the reduced 3.5% disbursement quota on capital assets also apply to charitable organizations. This amendment is achieved by changing the reference to “public foundation” or “charitable foundation” in the definition for disbursement quota in subsection 149.1(1) to “registered charity” and

inserting references to “charitable organization” where applicable. The reduced 3.5% disbursement quota will apply to public and private foundations with taxation years that being after March 22, 2004. For charitable organizations registered after March 22, 2004, however, the 3.5% disbursement quota will apply to their taxation years that begin after March 22, 2004. For charitable organizations registered before March 23, 2004, the 3.5% disbursement quota will apply to their taxation years that begin after 2008. Paragraph 149.1(2)(b), dealing with the circumstances under which the charitable status for charitable organizations may be revoked, has also been amended to reflect that the 3.5% disbursement quota applies to charitable organizations. Alternate wording for paragraph 149.1(2)(b) has also been introduced to deal with the transaction period for charitable organizations between 2004 and 2008. However, it appears that paragraph 149.1(21)(c) regarding “disbursement excess” for charitable organizations has not been amended to provide a corresponding amendment. Hopefully this will be amended in the final form of the draft legislation before it is introduced into Parliament.

As indicated in *Charity Law Bulletin* No. 41, with the removal of this key distinction between charitable organizations and foundations, there will be little functional difference between the two, other than the 50% income disbursement rules. It would therefore not be surprising if the Department of Finance, as a matter of policy, eventually eliminates the distinction between charitable organizations and foundations altogether so that there would be only two categories of charities, i.e. charities and private foundations. It will be interesting to see what may transpire in this regard over the next few years.

F. NEW CONCEPT OF “ENDURING PROPERTY”

The September 2004 Amendments introduce a new concept of “enduring property” and propose to amend the amount for variable “A” when calculating the disbursement quota to include 80% of the total of the eligible amounts of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than the following gifts that are:

- (a) enduring property; or
- (b) received from another registered charity.

The proposed definition for “enduring property” in subsection 149.1(1) will include the following:

- (a) a gift received by the charity by way of a bequest or inheritance, including a gift deemed by subsection 118.1(5.2) or (5.3) of the Act ⁹;
- (b) a ten-year gift received by the charity (i.e. the “original recipient charity”) with the gift, or property substituted for the gift, subject to a trust or direction that the property is to be held by the original recipient charity or by another registered charity (i.e. “transferee”) for a period of not less than 10 years from the date the original recipient charity received the gift, except that the trust or direction may permit the original recipient charity or the transferee to expend the property before the end of 10 years to the extent permitted under the definition for disbursement quota in order to meet the disbursement quota requirement; and
- (c) a gift received by the charity as a transferee of an enduring property under (a) or (b) above from either an original recipient charity or another transferee charity, provided that if it is an enduring property under (b), the gift is subject to the same terms and conditions under the trust or direction.

The new definition applies in respect of taxation years that begin after March 22, 2004. The following are several observations regarding the new concept of “enduring property”:

1. New broad concept

The term “enduring property” is very broad and includes gifts of bequest or inheritance and ten-year gifts that are included in the formula for variable “A” prior to the proposed amendments, as well as life insurance proceeds, registered retirement income fund and registered retirement savings plan as a result of direct beneficiary designation, and gifts received by the charity as a transferee of an enduring property that are 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.

2. Gifts by way of bequest or inheritance: income vs. capital

In relation to gifts received by a charity by way of bequest or inheritance, these gifts will no longer be limited to “gifts of *capital* received by way of bequests or inheritance” [emphasis added] under the

⁹ Details regarding amendments to subsection 118.1(5.2) and (5.3) of the Act concerning gifts of life insurance proceeds, registered retirement income fund and registered retirement savings plan as a result of direct beneficiary designation are explained in Section F4 below.

definition of disbursement quota prior to the proposed amendments. This means that a testamentary income interest received by a charity would now be included as part of an enduring property.

3. Ten-year gifts subject to ability to encroach

The definition of “enduring property” will also permit ten-year gifts that are subject to trusts or directions that may permit the original recipient charity or the transferee to expend the ten-year gifts before the end of 10 years to the extent permitted under the definition for disbursement quota in order to meet the disbursement quota requirement. Our comments concerning the limit on the encroachment is set out in Section G below.

4. Gifts made by way of direct designation

As a result of amendments to the Act introduced by the 2000 Federal Budget, payments of life insurance proceeds [paragraph 118.1(5.2)], registered retirement income fund or registered retirement savings plan [paragraph 118.1(5.3)] as a result of direct beneficiary designation were deemed to be gifts for the purposes of section 118.1 in respect of deaths that occur after 1998, provided that requirements under subsections 118.1(5.1), (5.2) and (5.3) are met. As such, upon the death of an individual, a charitable donation tax receipt can be provided to the estate and the executor can claim the donation tax credit on the deceased’s terminal income tax return. However, CRA’s technical interpretation document number 2002-0133545 dated January 16, 2003 confirms that “these payments have not been deemed to be gifts for purposes other [than] section 118.1, they are not gifts for purposes [of] the calculation of the DQ pursuant to the definition in subsection 149.1(1) of the Act and, therefore, are not included therein.”¹⁰

The September 2004 Amendments address this issue by amending subsections 118.1(5.2) and (5.3) and the definition of enduring property, by including these gifts as enduring property, and therefore are included in the calculation of the disbursement quota. These gifts will be subject only to the 3.5% disbursement quota while they are held as capital by the charity and will then become subject to the 80% disbursement quota requirement in the year in which they are disbursed. This amendment applies in respect of deaths after 1998, which retroactivity may lead to hardship for charities that relied on the

¹⁰ See also CRA’s *Registered Charities Newsletter*, dated April 2, 2003.

earlier position of CRA that such direct designation would not be included in the charities' disbursement quota from the enactment of subsections 118.1 (5.1) to (5.3) in 2000 to the present.

5. Transfer of ten-year gifts

Paragraph (c) of the definition for "enduring property" will permit a ten-year gift to be transferred to another registered charity during the ten-year period as if the ten-year gift had been received directly from the original donor, without the amount transferred affecting the disbursement quota for both the transferor charity and the recipient charity. This is further explained in Section H below concerning inter-charity transfers.

G. ENCROACHMENT OF ENDURING PROPERTY

Prior to the proposed amendments, variable "A.1" of the disbursement quota requires the inclusion of gifts received by a charity by way of bequest or inheritance or ten-year gifts that have previously been excluded in the calculation of disbursement quote under variable "A" in the year they are expended. As explained in the 2004 Budget, since an annual disbursement quota is applied to funds held by charities, sometimes, charities may prefer to meet its obligations to satisfy the disbursement quota by realizing capital gains rather than disbursing investment income earned from these funds, especially where the return on the investment is weighted heavily in favour of capital gains. However, "if the charity does so, . . . it must then meet an 80 per cent disbursement obligation to the extent that the proceeds of disposition are expended by the charity."¹¹

The difficulty caused the wording in the Act is addressed by the September 2004 Amendments by amending variable "A.1" of the disbursement quota by allowing the charity to encroach on the capital gains of enduring property up to a maximum of the "capital gains pool" of the charity, which is another concept introduced by the September 2004 Amendments. In this regard, variable "A.1" is proposed to be defined to be equal to 80% of the amount by which the total amount of enduring property owned by the charity to the extent that it is expended in the year exceeds the lesser of (i) 4.375 per cent (i.e. 5/4 of 3.5%) of the amount determined for variable "D" and (ii) the capital gains pool of the charity for the taxation year. This proposal will apply to taxation years that begin after March 22, 2004. It is important to note the following in relation to the new definition of variable "A.1":

¹¹ See the 2004 Budget.

1. Limit on encroachment

This formula permits expenditure of enduring property provided that the expenditure is the lesser of (i) 4.375 per cent (i.e. 5/4 of 3.5%) of the amount determined for variable “D” and (ii) the capital gains pool of the charity for the taxation year.

a) Calculation of variable “D”

The calculation for the amount for variable “D” remains substantially the same as the definition prior to the proposed amendments, i.e. the average value (i.e. the “prescribed amount”) of assets of the charity in the 24 months immediately preceding that taxation year that was not used directly in charitable activities or administration of the charity. The reference to variable “D” for purposes of calculating the limit on the encroachment does not take into account the variables “E” or “F” as required when calculating the 3.5% disbursement quota as described in the formula $\{C \times 0.035 [D - (E + F)]\} \div 365$.

b) “Capital gains pool”

The new definition “capital gains pool” applies for the purpose of the definition “disbursement quota”, applicable to taxation years that begin after March 22, 2004. Generally, the capital gains pool of a registered charity for a taxation year is the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004, less the total disbursement requirement of the charity under variable “A.1” of the definition for disbursement quota in respect of the expenditure of such enduring properties in a preceding taxation year that began after March 22, 2004. However, the capital gains from a disposition of a bequest or inheritance received by the charity before 1994 is not included. It is important to note that the capital gains pool only consists of all capital gains realized by the disposition of enduring property, rather than accrued gains. Further, the concept of the “capital gains pool” appears to be based on a tax policy in imposing an arbitrary cap on the ability of charities to encroach on the original capital of testamentary gifts and ten-year gifts in order to meet the 3.5% disbursement quota, instead of being able to encroach up to the amount required to satisfy the 3.5% disbursement quota.

To summarize, as explained in the Explanatory Notes that accompanied the September 2004 Amendments, “[t]he requirement to disburse 80% of the amount of an enduring property expended in the year is extended to such property received by way of gift in the same year” and it further provides

that “[h]owever, this requirement is reduced by the lesser of 3.5% of the investment assets of the charity and 80% of the “capital gains pool” of the charity.”

2. Exclusion of certain enduring property

When calculating variable “A.1”, the following enduring properties will not be included:

- enduring properties included in variable “A.2”;
- enduring properties received by the charity as “specified gifts”; and
- a bequest or an inheritance received by the charity in a taxation year that included any time before 1994.

The above exceptions in relation to variable A.2 and “specified gifts” are commented upon in Section H below concerning inter-charity transfers.

3. Gifts received and spent in the same year

Prior to the proposed amendments, long-term gifts (i.e. ten-year gifts and gifts received by way of bequest or inheritance) are subject to an 80% disbursement quota to the extent that the registered charity liquidates and spends the capital in the year following the year in which the gift is received. The rules prior to the proposed amendments, however, do not address the situation where the charity receives a long-term gift and disburses it in the same year. The September 2004 Amendments eliminate this loop-hole by removing the requirement under the calculation of variable “A.1” gifts that have previously been excluded from the charity’s disbursement quota. As such, it applies the 80% disbursement quota to gifts that are liquidated in the same year that they are received.

H. INTER-CHARITY TRANSFER

1. Gifts transferred to charitable organizations

Prior to the proposed amendments, only transfers from registered charities to public and private foundations are subject to the 80% disbursement quota, which mean that transfers from registered charities to charitable organizations are exempt from the 80% disbursement quota. The September 2004 Amendments propose that all transfers from one registered charity to another, including transfers to charitable organizations, will be subject to the 80% disbursement requirement. The only exceptions are transfers involving specified gifts and enduring property. This is achieved by applying

variable “B” to charitable organizations. Variable “B” is now defined to mean as follows:

(a) in the case of private foundations, variable “B” is the total of all amounts received by it in its immediately preceding taxation year from a registered charity, other than specified gifts or enduring properties; and

(b) in the case of charitable organizations and public foundations, variable “B” is the same as the case for the private foundation, except that the inclusion rate is 80%, rather than 100%.

This means that gifts of enduring property received from another registered charity will no longer be subject to the disbursement quota of the recipient charity in the year after the year in which it is received. Such gifts will be subject to the same requirements as those that apply to gifts of enduring property received from other persons. The exception for a “specified gift” will continue to apply. These changes will apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004.

2. Transfer of ten-year gifts

Due to a drafting error in the definition of the disbursement quota in the Act prior to the proposed amendments, if a charity transfers a ten-year gift to another charity, the transferee charity has to expend 80% of the ten-year gift in the year following the transfer of the gift. In order to avoid the recipient charity having to include the amount it received in its disbursement quota and having to expend 80% of the amount in the following year, the recipient charity is required to recognize the amount received as a specified gift. However, in order for the amount transferred to be recognized as a specified gift, the amount has to be designated as such by the transferor charity. The disposition of the property as a specified gift by the transferor charity means that the transferor charity is not permitted to include the amount transferred in meeting its disbursement quota to off-set the inclusion of the amount transferred in the calculation of the disbursement quota as a result of the expenditure of the ten-year gift. To overcome this difficulty, the transferor charity or the transferee charity would have to obtain relief from CRA by applying for dispensation from the application of the disbursement quota under subsection 149.1(5) of the Act.

In order to address this anomaly, the September 2004 Amendments propose to exempt the transfer of enduring property from variable “B”. The effect of this would be that a gift of enduring property received by a charity would not need to be included in the disbursement quota of the recipient charity. This exemption, therefore, would not require that the enduring property received be expended in the following year by the recipient charity. With respect to the transferor, this anomaly is proposed to be resolved by a new variable “A.2”, which is defined in paragraph 149.1(1) to mean the fair market value (at the time of the transfer) of enduring property (other than enduring property that was received by the charity as a specified gift) transferred by a charity in the taxation year by way of gift to a qualified donee. In this regard, the Explanatory Notes indicate that a different disbursement requirement applies for an enduring property that is expended by way of gift to a qualified donee. The charity must disburse 100% of such an amount (which requirement is satisfied by the gift itself). This means that the transferor charity would be able to include the amount of enduring property it transfers to a qualified donee in order to meet its disbursement quota requirement, which would off-set the increase in disbursement quota of the transferor charity as a result of disposing of the enduring property to the qualified donee. This proposal also applies to taxation years after March 22, 2004.

If the enduring property being transferred was inadvertently designated by the transferor charity as a specified gift, such designation would not cause any negative effect on the disbursement quota on the recipient charity because variable “B” also exempts specified gifts received by the charity from being included in the recipient charity’s disbursement quota. However, such a designation would lead to an unintended negative effect on the disbursement quota of the transferor charity, because the disposal of a specified gift is not exempt from variable “A.2” and, therefore, the amount must be included in the disbursement quota of the transferor charity, leading to the same unfavourable result caused by the drafting error in the Act prior to the proposed amendments. A possible way to resolve this is to amend variables “A.1” and “A.2” to also exempt specified gifts “transferred by” the charity in question.

3. Transfer as a result of penalty

The Explanatory Notes indicate that subsection 149.1(1.1) of the Act provides that a gift or expenditure made by a registered charity will not be considered in determining whether it has met its annual disbursement quota if the gift is made by way of a specified gift or if the expenditure is on political activities. Subsection 149.1(1) will be amended by the September 2004 Amendments, consequential to the amendment of Part V of the Act in respect of taxes and penalties for which the

charity is liable under subsection 188(1.1) or section 188.1 of the Act. Now paragraph 149.1(1.1)(c) provides that a transfer to another registered charity under that Part does not qualify as an expenditure for the purposes of calculating the transferor's disbursement quota. This amendment will apply in respect of notices of intention to revoke the registration of a charity and to notices of assessment issued by the Minister of National Revenue after the later of December 31, 2004 and 30 days after Royal Assent.

I. SUMMARY OF THE PROPOSED NEW DISBURSEMENT QUOTA RULES

The following table summarizes the new disbursement quota rules:

Registered Charities	Proposed Disbursement Quota = A + A.1 + A.2 + B + {C x 0.035 [D - (E + F)]}+365				
	"A"	"A.1"	"A.2"	"B"	{C x 0.035 [D - (E + F)]}+365
Charitable Organizations and Public Foundations	80% of all eligible amount of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than: (a) gifts of enduring property; (b) gifts received from other registered charities. "Enduring property" means property that is: (a) gifts of bequest or inheritance, including life insurance proceeds, RRSPs, and RRIFs by direct beneficiary designation (b) ten-year gifts (c) gifts received by the charity as a transferee of enduring property that are gifts of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity, provided that if the gifts are ten-year gifts, the gifts are subject to the same terms and conditions under the trust or direction	80% of the amount by which the total amount of enduring property owned by the charity to the extent that it is expended in the year exceeds the lesser of (i) 4.375 per cent (i.e. 5/4 of 3.5%) of the amount determined for "D" and (ii) the capital gains pool of the charity for the taxation year "Enduring property" not included in "A.1" = (a) enduring properties included in "A.2" ; (b) enduring properties received by the charity as "specified gifts"; and (c) a bequest or an inheritance received by the charity in a taxation year that included any time before 1994 See definition for "capital gains pool" in the note below	the fair market value (at the time of the transfer) of enduring property (other than enduring property that was received by the charity as a specified gift) transferred by a charity in the taxation year by way of gift to a qualified donee	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts and enduring property	3.5% of [{"D" - "E" - "F"}] ♦ "D" = average value of assets of the charity in the 24 months immediately preceding the taxation year that were not used directly in charitable activities or administration of the charity ♦ "E" = A.2 + 5/4 of ("A" + "A.1") ♦ "F" = 5/4 of "B" = 100% of all amounts received from registered charities in its immediately preceding taxation year
Private Foundations	same as above	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that "F" = "B", not 5/4 of "B"

NOTE: "Capital gains pool" of a registered charity for a taxation year = the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004, less the total disbursement requirement of the charity under variable A.1 of the definition for disbursement quota in respect of the expenditure of such enduring properties in a preceding taxation year that began after March 22, 2004. However, the capital gain from a disposition of a bequest or inheritance received by the charity before 1994 is not included.

J. CONCLUSION

The above is a summary of the proposed new rules regarding disbursement quota for charities. Although many aspects of the proposed new rules reflect a bona fide attempt by the Department of Finance to address a number of problems facing charities involving the disbursement quota, the complexities introduced by the new disbursement quota rules are such as to make them difficult, if not impossible, for the average charity to understand, let alone comply with. Even with a more detailed Disbursement Quota Worksheet for the Registered Charity Information Return - T3010A to assist in the annual calculation of the disbursement quota, charities will still be left in a vulnerable position. This is because charities not only need to be able to compute the disbursement quota at their fiscal year end for purposes of completing their T3010A, they also need to have a good working knowledge of the computation of the disbursement quota that they are required to satisfy in order to enable them to make informed decisions when planning their receipt and disbursement of funds throughout the year so that their decisions will not negatively impact their ability to meet their disbursement quota requirements. In this regard, the proposed new disbursement quota rules will be too complicated for volunteers, and even professionals, involved with charities to understand and to comply with.

In addition, there are concerns about the application of the proposed 3.5% disbursement quota being extended from charitable foundations to charitable organizations and the exemption of transfers of capital to charitable organizations from other registered charities being removed. This is a major change in tax policy by the Department of Finance that would blur the line between public foundations and charitable organizations to the point that the need for public foundations may be eliminated all together, leaving only charitable organizations and private foundations.



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