

COMPLEXITIES OF THE DISBURSEMENT QUOTA CONSULTATION: MORE THAN JUST A NUMBER

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A. INTRODUCTION

AS ANTICIPATED, the Department of Finance Canada (“Finance Canada”) launched a public consultation on August 6, 2021 (the “Consultation”) in order to consider a potential increase of the annual disbursement quota (“DQ”).¹ The DQ is the minimum amount that a charity must spend on its charitable activities or gifts to qualified donees to ensure that charitable funds are used for charitable purposes and are not accumulated indefinitely. It is determined based on the value of a charity’s property (e.g., real estate, investments) that is not used for charitable activities or administration. A potential increase to the DQ was first proposed in the 2021 Federal Budget released on April 19, 2021.² The Consultation, first announced on August 6, 2021, closes on September 30, 2021.

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¹ “Consultation: Boosting Charitable Spending in Our Communities” (6 August 2021), online: *Government of Canada* <<https://www.canada.ca/en/department-finance/programs/consultations/2021/boosting-charitable-spending-communities.html>>.

² “Budget 2021” (19 April 2021), online: *Government of Canada* <<https://www.budget.gc.ca/2021/report-rapport/toc-tdm-en.html>>; See also Terrance S. Carter et al., *Charity & NFP Bulletin* No 492 “Federal Budget 2021: Impact on Charities and Not-For-Profits” (20 April 2021), online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2021/chylb492.pdf>>; and Terrance S. Carter and Jacqueline M. Demczur, *Charity & NFP Law Update June 2021* “Pending Disbursement Quota Consultations: Questions for Consideration” (June 2021), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/update/charity/21/jun21.pdf>>.

The Budget 2021 initiative comes at a time when there has been increased public discussion about the DQ. Much of that discussion revolves around if and by how much the DQ should be increased. These two questions, among others, have also been raised in the Consultation.³

Finance Canada's Backgrounder to the Consultation includes comparisons to the United States and Australia where private foundations and funds have a minimum 5% disbursement requirement,⁴ while the Conservative election platform proposes a DQ of 7.5%.⁵ Other proposals have ranged as high as 10%.⁶ However, a thoughtful consultation about the DQ involves more than simply picking a number. It also requires consideration of the complex legislative and policy environment in which the DQ exists and the impact that any change in the DQ rate might have on registered charities.

B. BRIEF HISTORICAL OVERVIEW

A BRIEF OVERVIEW of the history of the DQ in Canada is helpful in understanding the complexities behind it. The DQ was first introduced in 1976 with the intent to ensure that a significant portion of a charity's resources were devoted to its charitable purposes. Charitable organizations and public foundations were required to disburse 80% of what they received in donations from the immediately preceding year, but gifts made to public foundations with directions by the donor that the gift be held by the charity for at least 10 years ("ten-year gifts") were exempt.⁷ Private foundations were required to disburse the greater of 5%

³ Finance Canada is seeking feedback on the following six questions:

- Should the disbursement quota be raised to produce additional funding for charities, and to what extent?
- Would it be desirable to increase the disbursement quota to a level that causes foundations to gradually encroach on investment capital, and would it be sustainable in the long-term for the sector?
- What additional tools (e.g., monetary penalties or other intermediate sanctions) should be available to the CRA to enforce the disbursement quota rules?
- Do the relieving and accumulation of property provisions continue to be useful for charities?
- Do the existing carry-forward provisions strike the appropriate balance between ensuring the timely disbursement of funds and allowing foundations to make large gifts on a more infrequent basis?
- Are there any temporary changes to the disbursement quota that should be considered in the context of the COVID-19 recovery?

See "Consultation," *supra* note 1.

⁴ "Backgrounder for Disbursement Quota Consultation" (6 August 2021) ["Backgrounder"], online: *Government of Canada* <<https://www.canada.ca/en/department-finance/programs/consultations/2021/boosting-charitable-spending-communities/backgrounder-disbursement-quota-consultation.html>>.

⁵ "Canada's Recovery Plan" (16 August 2021), online (pdf): *Conservative Party of Canada* <<https://cpcassets.conservative.ca/wp-content/uploads/2021/08/16102359/f8279981721e07a.pdf>>.

⁶ John Hallward, "Unlocking the Expanding Wealth of Charitable Foundations" (20 May 2020), online: *Policy Options* <<https://policyoptions.irpp.org/magazines/may-2020/unlocking-the-expanding-wealth-of-charitable-foundations/>>.

⁷ Theresa L. M. Man, *2011 National Charity Law Symposium* "Disbursement Quota Reform: The Ins and Outs of What You Need to Know" (6 May 2011), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/article/charity/2011/tlm0506.pdf>>.

of the fair market value of their non-arm's length investments and 90% of the actual income therefrom.⁸ Private foundations were also required to distribute at least 90% of income received from other sources, such as from qualified investments.⁹

In 1984, legislative changes were made requiring all charities to disburse 80% of the gifts received in the previous year (subject to exceptions). Ten-year gifts and testamentary gifts to charitable organizations became exempt from the DQ, while public foundations were required to disburse 80% of the gifts they received in the previous year from registered charities.¹⁰ Private foundations had to disburse 100% of gifts they received from other charities.¹¹ The disbursement requirement based on the value of property not used in charitable programs or administration was lowered to 4.5% but was made applicable to both private and public foundations.¹²

In 2004, the 4.5% portion of the DQ was reduced to 3.5% and then extended to charitable organizations.¹³ However, foundations (both public and private) as well as charitable organizations with \$25,000 in assets or less were exempted from the 3.5% DQ.¹⁴ Interest rates were “low” at the time and, as a result, many charities were struggling to meet their DQ requirements without expending a portion of the capital of their bequests or long-term gifts.¹⁵ The then new 3.5% DQ 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.”¹⁶

⁸ This rule did not apply to arm's length investments in the open market (*i.e.*, qualified investments, such as publicly traded securities), capital property used directly in the foundation's own activities or amounts being accumulated for specific projects approved by the Minister of National Revenue. See Theresa LM Man, *ibid.*

⁹ Theresa LM Man, *ibid.*

¹⁰ Theresa LM Man, *ibid.*

¹¹ Theresa LM Man, *ibid.*

¹² “Backgrounder”, *supra* note 4.

¹³ *The Budget Plan 2004* “Annex 9 Tax Measures: Supplementary Information and Notice of Ways and Means Motions” (23 March 2004), online (pdf): *Government of Canada* <<https://budget.gc.ca/pdfarch/budget04/pdf/bp2004e.pdf>>; *Budget Implementation Act, 2004, No. 2, SC 2005, c 19, s 35 (1)*.

¹⁴ *Budget Implementation Act, 2004, No. 2, SC 2005, c 19, s 35 (1)*. See also *Income Tax Act*, RSC 1985, c 1 (5th Supp), ss 149.1(1), 248(1) definitions of “disbursement quota” and “registered charity” as they appeared on 13 March 2005.

¹⁵ Interest rates were 2.25% which was low in comparison to earlier rates. See Letter from Florence Carey, Chair, CBA Charities and Not-for-Profit Law Section to the Honourable Chrystia Freeland (15 June 2021) published online: *The Canadian Bar Association* <<https://www.cba.org/CMSPages/GetFile.aspx?guid=164448c5-bdca-4d8a-999f-06b23d981111>>.

See also Terrance S Carter and Jacqueline M Demczur, *supra* note 2.

¹⁶ *The Budget Plan 2004*, *supra* note 13.

In 2010, the legislation changed again and charities were no longer required to disburse 80% of the amount received in donations during the previous fiscal year. The elimination of the 80% disbursement quota requirement was strongly supported by the charitable sector at the time. This was because the 80% disbursement quota had created an unnecessarily onerous administrative burden that few charities (especially small and rural ones) had the resources with which to be able to comply.¹⁷ Also as of 2010, charitable organizations could hold up to \$100,000 in assets not used for charitable programs or administration without being required to comply with the DQ, although the threshold remained at \$25,000 for public and private foundations.¹⁸

C. CURRENT CONTEXT

RECENT PUBLIC DISCUSSION of the DQ has highlighted varied concerns about how charitable organizations and foundations manage their property. Some wonder if charities are “hoarding” funds,¹⁹ while others maintain that policy makers are not looking at enough data.²⁰ However, while much focus and discussion surrounding the Consultation has been with respect to increasing the DQ percentage, a holistic view of the DQ is needed – one that takes into consideration more than just the percentage of assets to be distributed.²¹ Further to this, there are several complex factors that need to be taken into account which are briefly outlined below.

1. A Lack of Relevant and Helpful Data

The first major complicating factor with regard to an effective reform of the DQ is the lack of available data. As noted in *Report #3 of the Advisory Committee on the Charitable Sector - July 2021*, it would be “problematic” to base policy decisions, such as an increase in the DQ rate, on high-level data from the

¹⁷ Karen J Cooper and Terrance S Carter, “Significant Benefit for Charities in 2010 Federal Budget DQ Reform”, *Charity & NFP Law Bulletin No. 197* (8 March 2010, revised 29 April 2010), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2010/chylb197.pdf>>.

¹⁸ *Supra* note 11.

¹⁹ Barbara Shecter, “Charities Hoarded Cash and Failed to Address Crises During COVID: Report”, *Financial Post* (6 August 2021) online: <financialpost.com/news/economy/charities-hoarded-cash-and-failed-to-address-crises-during-covid-report>.

²⁰ Letter from Bruce MacDonald, President & CEO of Imagine Canada and Cathy Taylor, Executive Director of Ontario Nonprofit Network to the Editor of Financial Post, *Ottawa Citizen* (17 August 2021) published online: *Imagine Canada* <<https://imaginecanada.ca/en/news-and-events/Letter-to-the-editor-Financial-Post-Ottawa-Citizen>>.

²¹ “Renewing our Social Contract: Private Philanthropy for the Public Good” (June 2021), online (pdf): *Philanthropic Foundations Canada* <https://pfc.ca/wp-content/uploads/2021/06/2021-06-15-pfc-policy-brief-dq_final-eng.pdf>.

T3010 reporting form (which charities must file with the Canada Revenue Agency (“CRA”)).²² This is because the lack of homogenous financial models and options across the charitable sector results in different understandings of T3010 reporting expectations. There is not enough data at an individual level which would show whether large charities, such as universities, are impacting the average percentage of overall DQ disbursements, thereby enabling legislators to target amendments to the DQ appropriately.

A second related issue is that there is no information concerning whether increasing the DQ will meet the government’s goal of increasing support for other registered charities, as well as non-profit organizations that collectively provide essential services to local communities. This is because T3010 data does not capture how and where a charity’s funds or resources are expended in order to meet its respective DQ. Specifically, funds or resources of a charity must be expended to accomplish a charity’s own programs or, alternatively, gifted to qualified donees²³ in order to meet its DQ. However, there is no data whatsoever to show if these funds or resources are directed to charities serving vulnerable communities, such as those affected by COVID-19. Additionally, some organizations working on the frontlines may not be qualified donees and, therefore, a change in the DQ is unlikely to provide them with further support. Simply increasing the DQ, without more information concerning where the increased funds to meet the DQ will be utilized, does not mean there will be additional funds going to assist front line organizations, whether they be charitable and non-profits, facing heightened demand for services.

2. Compliance May Become Overcomplicated

An important factor to consider is how a change to the existing DQ obligations may result in complex and expensive compliance issues for registered charities. By way of comparison, the 80% disbursement quota

²² “Update on the Charitable Sector Data Working Group”, *Report #3 of the Advisory Committee on the Charitable Sector – July 2021* (3 August 2021), online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/corporate-reports-information/advisory-committee-charitable-sector/report-advisory-committee-charitable-sector-july-2021.html#h5>>.

²³ For a full definition of “qualified donee”, see *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), s. 149.1(1) [“ITA”]. The CRA summarizes the list as follows: a registered charity; a registered Canadian amateur athletic association; a registered housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged; a registered Canadian municipality; a registered municipal or public body performing a function of government in Canada; a registered university outside Canada the student body of which ordinarily includes students from Canada; a registered charitable organization outside Canada to which Her Majesty in right of Canada has made a gift; Her Majesty in right of Canada, a province, or a territory; the United Nations and its agencies; and registered journalism organizations. See *Canada Revenue Agency Guidance CG-010 “Qualified Donees”* (15 August 2011), online: *Government of Canada* <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/qualified-donees.html>>.

abolished in 2010 had numerous difficult-to-understand concepts and rules, which increased the administrative burdens of charities trying to comply with the legislation.²⁴

Depending on what is ultimately proposed by Finance Canada, an increased DQ could result in a similarly heavy compliance burden for charities, particularly if it comes into conflict with existing legal obligations. For example, restricted funds held by charities (such as perpetual endowments and other long-term funds) may have restricted terms prohibiting encroachment on capital, which, if not complied with without court approval, would amount to a breach of trust.²⁵ In such situations, the capital of these restricted funds would not be available to these charities to utilize to meet their increased DQ requirements. While applications to the court to vary the terms of these trusts are possible, the reality is that such applications are costly and would result in more funds being directed to professionals, including lawyers and accountants, rather than to charitable programs and activities. Furthermore, there is no guarantee that the courts would grant an order allowing the capital of restricted fund be available for DQ disbursements.

As well, as some in the charitable sector have suggested, if an increased DQ was to apply at the individual fund level,²⁶ then this could result in significantly increased administrative costs on charities related to these new DQ calculation and reporting obligations at the individual fund level. This would particularly be the case for educational and health care charities that often hold many perpetual endowed funds, as well as long term/non-endowed restricted funds. It is doubtful whether compliance with such a complex DQ scheme is even possible, especially in situations where charities may hold a significant number of small endowments, such as colleges and universities.

Furthermore, while discussions have been focused on increasing the DQ to release endowments held by foundations, many charitable organizations likewise hold endowments. Since charities are currently

²⁴ For a visual representation of the complexities of the old DQ rules, see Theresa L. M. Man and Terrance S. Carter, “Disbursement Quota Formula Under Bill C-33 (March 2004 Federal Budget Enabling Legislation)”, *Charity Law Bulletin*, No. 67 (31 March 2005), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2005/chylb67-05.pdf>>.

²⁵ Letter, *supra* note 15.

See also, Adam Parachin, “From WE to DQ – Liberal’s Charity Disbursement Quota Reform Misses the Mark”, *The Globe and Mail* (24 June 2021) online: <<https://www.theglobeandmail.com/business/commentary/article-from-we-to-dq-liberals-charity-disbursement-quota-reform-misses-the/>>.

²⁶ Imposing the DQ on individual donor-advised funds was a proposed solution to challenges associated with donor-advised funds including delays in distribution of benefits to charities. See Canada, Special Senate Committee on the Charitable Sector, *Catalyst for Change: A Roadmap to a Stronger Charitable Sector*, (Final Report), (Ottawa: Senate of Canada, June 2019) at 112, online: <https://sencanada.ca/content/sen/committee/421/CSSB/Reports/CSSB_Report_Final_e.pdf>.

permitted to meet their DQ by making charitable disbursements from their non-endowed assets, increasing the DQ may have no impact on charitable organizations where their disbursements from non-endowed assets are more than enough to meet their DQ obligations. If the DQ was to be revised to apply differently to charitable organizations and foundations to address this issue, it would again result in an extremely complex DQ regime which would increase the administrative costs of charities and result in a compliance nightmare.

3. Expanding What is Acceptable as a Charitable Disbursement for Purposes of Meeting the DQ

At present, any type of investment by a charity that involves the dual purpose of achieving a charitable purpose of the charity and seeking some type of financial return, do not count as a recognized charitable disbursement for purposes of meeting the DQ.²⁷ Key examples of these types of investments include impact investments, social investments, social finance, and program related investments, collectively referred to as “program related investments” (“PRIs”) by the CRA’s administrative guidance CG-014, *Community Economic Development Activities and Charitable Registration*.

This failure by the CRA to recognize PRIs as a charitable disbursement is clearly a disincentive for charities with large investment assets from investing those assets in PRIs and, in so doing, are precluded from making a difference for good in achieving their charitable purposes.²⁸ As such, no matter what other changes may be made to the DQ going forward by Finance Canada, the CRA should revise its administrative policy so that investments by charities in dual purpose PRIs be counted toward meeting their DQ at whatever percentage it may be set at.

D. CONCLUSION

THERE HAS BEEN an accumulation of investment assets by foundations in Canada along with a simultaneous heightened demand and strained revenues for charities. However, because the data on

²⁷ See *Canada Revenue Agency Guidance CG-014*, “Community Economic Development Activities and Charitable Registration” (26 July 2012, revised 9 August 2017), online: *Government of Canada* <www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/community-economic-development-activities-charitable-registration-014.html> at paras 39 – 68.

²⁸ For a more detailed discussion of why PRIs should be included as a charitable disbursement, see Terrance S Carter, *Ontario Bar Association’s Institute 2018 – Critical Development in Charity and Not-for-Profit Law* “The Investment Spectrum for Charities, Including Social Investments” (6 February 2018) online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/seminar/charity/2018/oba/OBA%20Paper%20Investment%20Spectrum.pdf>>.

charitable spending is incomplete, it is difficult to predict if an increase in the DQ rate will be effective in addressing the increased financial demands being faced by charities.

Accordingly, careful consideration must be given to unintended consequences arising from the question of whether, and how, the DQ should be changed, including the current administrative policy of the CRA concerning PRIs. A key factor in this regard must be how any increase in the DQ will most effectively help charities appropriately manage their resources and, at the same time, serve the public good, rather than simply choosing from a spectrum of possible arbitrary percentages to arrive at a new DQ rate.

The complexities of these issues require a careful discussion of all considerations. This is important to do as the charitable sector needs a much more nuanced approach than simply picking a number.



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