
REMINDER FOR CHARITIES TO TAKE THE NECESSARY STEPS TO MEET THE DQ

*By Terrance S. Carter and Theresa L.M. Man**

A. INTRODUCTION

Following the proposal for a public consultation to potentially increase the 3.5% Disbursement Quota (“DQ”) in the April 2021 Federal Budget, there has been much discussion in the charitable sector regarding charitable tax policy as it relates to the DQ, including in our own firm’s submission in [Charity & NFP Law Bulletin No. 498](#). However, what has been overlooked in the discussion is an understanding of the process that charities are required to follow in order to calculate and meet the DQ, whether or not the DQ rate is to be changed.

The DQ is a requirement set out in subsection 149.1(1) of the *Income Tax Act* (“ITA”) and is the minimum amount that a charity must spend on its charitable activities or gifts to qualified donees to ensure that its charitable assets are used for charitable purposes and are not simply accumulated indefinitely. The 3.5% DQ obligation applies to property owned by the charity in the preceding 24 months that is not used directly in charitable activities or administration.

This *Bulletin* sets out a brief outline of the steps charities would need to take to comply with the DQ rules, and highlights a few key areas to pay attention to.

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B. STEPS TO COMPLY WITH DQ RULES

(1) Identify the property for the asset base – The first step is for the charity to calculate the property not used directly in charitable activities or administration. The Canada Revenue Agency (“CRA”) lists the following examples of property to which the DQ may apply in their [publication](#) on how to calculate the DQ: cash in bank accounts, inventory, stocks, bonds, mutual funds, GICs, land, and buildings.¹ The CRA also indicates that if a portion of a building that is normally used in charitable programs is being used for non-charitable activities (*e.g.* a church rents out a part of its building to a for-profit daycare), then the portion that is rented out will need to be pro-rated and included in the calculation. Charities should be aware, however, that specific guidance about how to pro-rate this calculation is not provided in the publication.

(2) Calculate the average value of the property – Once the relevant property has been identified, charities will need to calculate the average value of the property. The average value of property is based on a specified number of periods (decided by the charity) over a 24-month span immediately preceding the fiscal period in question. Charities may choose between two to eight equal, consecutive periods over that 24-month period. Once a charity has chosen the number of valuation periods, it must consistently use this number of valuation periods and can only change it with the CRA’s permission. For example, a charity that uses four valuation periods over a 24-month period (*i.e.*, 4 six-month periods) will need to calculate the value of the property for each of the six-month periods, add them up, and then divide that amount by four to come to the average value of the asset base.

(3) Calculate the 3.5% DQ obligation – The average value of the asset base will need to be entered on line 5900 of the charity’s T3010 *Registered Charity Information Return*. The DQ obligation of the charity will be 3.5% of this amount, provided that this amount is greater than \$100,000 for charitable organisations and \$25,000 for charitable foundations. Failure to complete line 5900 with correct information can give rise to suspension of receipting privileges or even result in revocation of charitable status in more egregious situations.

(4) Track expenditures to meet 3.5% DQ obligation – Once a charity has calculated its DQ obligation, it is required to track its expenditures to ensure that the DQ obligation is met. At a minimum, the charity must expend at least the amount of its DQ obligation on gifts to qualified donees or on its own charitable

¹ Canada Revenue Agency, “Disbursement quota calculation” online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/annual-spending-requirement-disbursement-quota/disbursement-quota-calculation.html>

activities. A “qualified donee” is defined in subsection 149.1(1) of the ITA and includes (among others) a registered charity, the Government of Canada, a province, a municipality, as well as a registered municipal or public body performing a function of government in Canada. Gifts to qualified donees are entered on line 5050 of the T3010. When gifts to qualified donees are made between non-arm’s length charities, there are [anti-avoidance rules](#) that will apply, including the option of making the gift a “designated gift.”² Also, regardless of whether charities are arm’s length or not, charities need to be aware of the anti-avoidance rule in paragraph 149.1(4.1)(a) of the ITA, whereby the charitable status of a charity may be revoked if it entered into a transaction (including a gift to another registered charity) where it may reasonably be considered that a purpose of the transaction was to avoid or unduly delay the expenditure of amounts on charitable activities.

With regard to expenditures on charitable activities that would meet the DQ obligation, [examples](#) provided by the CRA include expenses in running day-to-day programs, occupancy costs (*e.g.* rent, mortgage payments, hydro), most salaries, and education and training for staff and volunteers.³ The amount tracked as charitable expenditures is to be entered on line 5000 of the T3010. However, this amount should not include expenditures for management, administration or fundraising. When there are expenditures that are considered partly charitable and partly management and administration (*e.g.* salaries and occupancy costs), the charity would need to make a reasonable and consistent allocation between line 5000 and 5010 for management and administration expenditures respectively.

It is important to note that [Program Related Investments](#) (“PRIs”) (commonly referred to as impact investments that directly further the investor charity’s charitable purpose) are generally not considered by the CRA to be charitable expenditures and therefore do not count toward meeting the charity’s DQ obligation.⁴ However, there are limited exceptions when PRIs may count as charitable expenditures for the purposes of the DQ, such as in circumstance where the charity is unable to recover part or all of the principal of a PRI or when a charity fails to meet its DQ obligation and there are lost opportunity costs as a result of a PRI.

² Canada Revenue Agency, “Anti-avoidance rules and designated gifts”, online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/receiving-gifts/anti-avoidance-rules-designated-gifts.html>

³ Canada Revenue Agency, “Completing Form T3010 Registered Charity Information Return”, online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4033/t4033-completing-registered-charity-information-return.html>

⁴ Canada Revenue Agency, *Guidance CG-014*, “Community economic development activities and charitable registration”, online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/community-economic-development-activities-charitable-registration-014.html#toc9>

(5) Track DQ excesses and shortfalls -Finally, charities must also track their DQ excesses and shortfalls from previous years. A DQ excess occurs when a charity spends more on charitable activities or gifts to qualified donees than its DQ obligation for the fiscal period in question and can be carried forward five years and back one year to meet DQ shortfalls in those years. Conversely, a DQ shortfall occurs when a charity disburses less on qualified donees or charitable activities than its DQ obligation for the year. A shortfall can be met using the DQ excesses from the past five years or from the following year. When circumstances beyond a charity’s control result in a DQ shortfall and there is no DQ excess to cover this amount, the charity may apply to the CRA for a [reduction](#).⁵

C. CONCLUSION

This brief overview of the DQ with links to CRA publications is intended to provide charities with a practical summary of the steps that charities must follow to monitor their DQ obligations and to ensure that they are met. Further information is contained in a recent PowerPoint presentation by Terrance Carter titled, “[The Disbursement Quota for Charities: Issues to Consider](#)”. Because the T3010 does not currently require the charity to indicate its calculation of its actual DQ obligation and whether that obligation is being met, charities must take care to track such information in their own records recognizing that repeated failure to meet a charity’s DQ obligation could result in revocation. In addition, providing incomplete or inaccurate information on the T3010 can result in suspension of receiving privileges or revocation. As such, charities will want to make sure that they take the necessary steps to ensure compliance with the DQ as they complete their T3010s.

⁵ Canada Revenue Agency, “Asking for a disbursement quota reduction” online: Government of Canada <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/making-changes/disbursement-quota-reduction.html>