

## DRAFT BUDGET IMPLEMENTATION LEGISLATION WILL INCREASE DQ AND AFFECT TRUST REPORTING

*By Terrance S. Carter, Theresa L.M. Man and Jacqueline M. Demczur \**

### A. INTRODUCTION

The disbursement quota is expected to soon be increased, as first announced in Budget 2022. Two pieces of draft legislation – one to make technical amendments to the *Income Tax Act* (“ITA”) and Income Tax Regulations (“Regulations”), and one to implement parts of Budget 2022, among other proposals, by amending the ITA and Regulations – has been released.<sup>1</sup> In particular, the draft legislation proposes changes to the disbursement quota (“DQ”), trust reporting, technical updates regarding filing returns, as well as listing of prescribed donees. The draft legislation was released by the Department of Finance on August 9, 2022, together with explanatory notes.<sup>2</sup> It is expected that the proposed changes will appear in budget implementation legislation to be introduced in the House of Commons when Parliament resumes in September 2022.

\* Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent, is the managing partner of Carters Professional Corporation and counsel to Fasken on charitable matters. Theresa L.M. Man, BSc, MMus, LLB, LLM, is a partner practicing in charity and not-for-profit law. Jacqueline M. Demczur, B.A., LL.B., is a partner practicing charity and not-for-profit law. The authors would like to thank Lynne Westerhof, B.A., J.D., for her assistance in preparing this *Bulletin*.

<sup>1</sup> Department of Finance Canada, “Legislative proposals relating to the *Income Tax Act* and the Income Tax Regulations (Technical Amendments)” (August 2022), online: Government of Canada <<https://fin.canada.ca/drleg-apl/2022/ita-lir-0822-l-1-eng.html>>; and Department of Finance Canada, “Legislative proposals relating to the *Income Tax Act* and the Income Tax Regulations (Budget 2022 and other proposals)” (August 2022), online: Government of Canada <<https://fin.canada.ca/drleg-apl/2022/ita-lir-0822-l-2-eng.html>>.

<sup>2</sup> Department of Finance Canada, “Explanatory Notes to Legislative Proposals Relating to the *Income Tax Act* and Regulations (Technical Amendments)” (August 2022), online: Government of Canada <<https://fin.canada.ca/drleg-apl/2022/ita-lir-0822-n-1-eng.html>>; and Department of Finance Canada, Explanatory Notes to Legislative Proposals Relating to the *Income Tax Act* and Regulations (Budget 2022 and Other Proposals)” (August 2022), online: Government of Canada <<https://fin.canada.ca/drleg-apl/2022/ita-lir-0822-n-2-eng.html>> [“Explanatory Notes”].

## B. DISBURSEMENT QUOTA

### 1. Background

The DQ has been the subject of much discussion in the charitable sector for the past few years.<sup>3</sup> The DQ is the minimum amount that a charity must spend on its charitable activities or gifts to qualified donees to ensure that charitable property is used for charitable purposes and is not accumulated indefinitely. The DQ obligation, currently set at 3.5%, applies to property (such as real estate, investments) that is not used directly in charitable activities or administration.<sup>4</sup> The DQ only applies if the value of this property exceeds \$25,000 for charitable foundations or \$100,000 for charitable organizations.

A potential increase to the DQ was first proposed in the 2021 Federal Budget released on April 19, 2021. Finance Canada launched a public consultation which ran from August 6, 2021 until December 2, 2021, in which stakeholders and interested members of the public were provided with the opportunity to provide feedback to Finance Canada on potentially increasing the DQ and updating the tools at the Canada Revenue Agency's ("CRA") disposal to enforce the DQ rules.<sup>5</sup> Following the consultation, on April 7, 2022, Budget 2022 was released which proposed that the DQ be increased from 3.5% to 5% for charities with investment assets above \$1 million.<sup>6</sup>

The *Budget Implementation Act, 2022, No.1* was tabled as Bill C-19 in the House of Commons shortly after the release of Budget 2022, receiving Royal Assent on June 23, 2022.<sup>7</sup> Bill C-19 introduced the new

---

<sup>3</sup> See, for example, the following summaries of discussions about the DQ in the charitable sector:

Terrance S. Carter & Jacqueline M. Demczur, "Pending Disbursement Quota Consultations: Questions for Consideration" (24 June 2021) *June 2021 Charity & NFP Update*, online: *Carters Professional Corporation*

<[https://www.carters.ca/index.php?page\\_id=369](https://www.carters.ca/index.php?page_id=369)>. Terrance S. Carter, Jacqueline M. Demczur & Theresa L.M. Man, "ACCS Makes Submission to Finance on the Disbursement Quota Consultation" (29 September 2021) *Sep 2021 Charity & NFP Update*, online: *Carters Professional Corporation* <[https://www.carters.ca/index.php?page\\_id=400](https://www.carters.ca/index.php?page_id=400)>; Terrance S. Carter, Jacqueline M. Demczur & Theresa L.M. Man, "CBA and CAGP Release Written Submissions on DQ Consultation" (28 October 2021) *Oct 2021 Charity & NFP Update*, online: *Carters Professional Corporation* <[https://www.carters.ca/index.php?page\\_id=419](https://www.carters.ca/index.php?page_id=419)>; Terrance S. Carter, Jacqueline M. Demczur & Theresa L.M. Man, "Imagine Canada and Pemsel Foundation Release Their Disbursement Quota Submissions" (25 November 2021) *Nov 2021 Charity & NFP Update*, online: *Carters Professional Corporation* <[https://www.carters.ca/index.php?page\\_id=432](https://www.carters.ca/index.php?page_id=432)>.

<sup>4</sup> For further information about the DQ, including historical DQ rates and rules, see Terrance S. Carter, Jacqueline M. Demczur & Theresa L.M. Man, "Complexities of the Disbursement Quota Consultation: More Than Just A Number" (26 August 2021) *Aug 2021 Charity & NFP Update*, online: *Carters Professional Corporation* <[https://www.carters.ca/index.php?page\\_id=380](https://www.carters.ca/index.php?page_id=380)>.

<sup>5</sup> "Consultation on Boosting Spending by Charities in Our Communities" (3 December 2021), online: *Government of Canada* <<https://www.canada.ca/en/departement-finance/programmes/consultations/2021/boosting-charitable-spending-communities.html>>.

<sup>6</sup> "Budget 2022" (7 April 2022), online: *Government of Canada* <<https://budget.gc.ca/2022/report-rapport/toc-tdm-en.html>>.

<sup>7</sup> Bill C-19, *Budget Implementation Act, 2022, No.1*, 1st Sess, 44th Parl, 2022 (Royal Assent 23 June 2022), S.C. 2022, c. 10. For more information on the *Budget Implementation Act, 2022, No. 1* and the legislative provisions it introduced that affect charities, see Terrance S. Carter & Theresa L.M. Man, *Charity & NFP Law Bulletin No. 511*, "Bill C-19 Budget Implantation Act, 2022, No. 1 Proposes Major Changes to Legislative Framework Governing Charities" (25 May 2022) online: *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb511.pdf>> and *Charity & NFP Law Bulletin No. 513*, "Bill C-19 is Amended to

regime of “qualifying disbursements” made to “grantee organizations” which would be included in calculating whether a charity has met its DQ obligations.

## 2. New Draft Legislation Amending the DQ

There are several changes to the DQ rules proposed in the draft legislation, including: amendments to DQ rate, clarification that administration and management expenditures cannot be used to meet DQ obligations, and technical DQ-related amendments.

### a) Formula to Calculate the DQ

The draft legislation proposes to amend the definition of “disbursement quota” in subsection 149.1(1) of the ITA by increasing the DQ rate from 3.5% to 5% for charities with investment assets over \$1 million. The asset base for the application of the DQ continues to apply to property owned by the charity in the preceding 24 months that is not used directly in charitable activities or administration as determined in sections 3701 and 3702 of the Regulations. The table below explains how certain charities may be affected by the proposed legislation.

Type of Charity and Value of Property* held by the Charity	Current DQ Obligation	Proposed new DQ Obligation
Charitable Foundation with ≤\$25,000 of property	Nil	Nil
Charitable Organization with ≤\$100,000 of property	Nil	Nil
Charitable Foundation with >\$25,000 and ≤\$1,000,000 of property	3.5% of property	3.5% of property
Charitable Organization with >\$100,000 and ≤\$1,000,000 of property	3.5% of property	3.5% of property
Charitable foundation with >\$1,000,000 of property	3.5% of property	\$35,000 + 5% of the amount of property which exceeds \$1,000,000
Charitable organization with >\$1,000,000 of property	3.5% of property	\$35,000 + 5% of the amount of property which exceeds \$1,000,000
* “property” refers to “property owned by the charity in the preceding 24 months that is not used directly in charitable activities or administration as determined under sections 3701 and 3702 of the Regulations		

Charities that exceed the \$1 million threshold specified above should be aware of how an increase in the DQ rate may complicate their compliance efforts. In particular, charities with endowments that specify that the capital is to be held in perpetuity or for a certain period of time may not be able to earn sufficient income on their investments to cover higher DQ obligations. In such a situation, a charity would either have to make riskier investments that could potentially pay a higher return (but which may result in the charity not complying with the “prudent investor” standard under applicable provincial trustee legislation) or apply to court to vary the terms of the endowment (potentially a costly endeavour).<sup>8</sup>

## b) Administration and Management Expenses do not Satisfy DQ Obligations

Budget 2022 proposed amendments be made to the ITA to clarify that expenditures for administration and management cannot be used for purposes of meeting the DQ obligation. As a result, a new paragraph (d) is proposed to be added to subsection 149(1.1) to provide that expenditures on “administration and management” of the charity will not satisfy a charity’s DQ obligation because these expenses are not “deemed” to be expenditures “expended in a taxation year on charitable activities nor [gifts] made to qualified donee[s].” The explanatory notes accompanying the draft legislation indicate that this provision “excludes expenditures for management, administration and fundraising from satisfying the disbursement quota requirements.” It also states that “whether a particular expenditure relates to management, administration and fundraising will be a factual determination based on the activities and practices of the organization.”<sup>9</sup>

However, the proposed changes raise a number of concerns. First, the draft legislation does not revise the opening wording of subsection 149.1(1.1), which only deems the expenses therein to be expenses on charitable activities and gifts to QDs, and thereby eligible to meet DQ obligations.

149.1 (1.1) For the purposes of paragraphs (2)(b), (3)(b) and (4)(b) and subsection (21), the following shall be deemed to be neither an amount expended in a taxation year on charitable activities *nor a gift made to a qualified donee*:

(a) a designated gift; and

---

<sup>8</sup> Terrance S. Carter, “Disbursement Quota Reform: Stabilizing a Three-Legged Stool” (March 2022) Perspectives on Tax Law & Policy, vol 3, no 1, online: *Canadian Tax Foundation* <<https://www.ctf.ca/CTFWEB/EN/NEWSLETTERS/PERSPECTIVES/2022/1/220106.aspx>>. See also, Terrance S. Carter, Jacqueline M. Demczur, and Theresa L.M. Man, “Complexities of the Disbursement Quota Consultation: More than Just a Number” (25 August 2021), *Charity & NFP Law Bulletin No. 498*, online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2021/chylb498.pdf>>.

<sup>9</sup> Explanatory Notes, *supra* note 2.

(b) [Repealed]

(c) a transfer that has, because of paragraph (c) of the description of B in subsection 188(1.1), paragraph 189(6.2)(b) or subsection 189(6.3), reduced the amount of a liability under Part V.

(d) expenditures on administration and management of the charity. [*emphasis added*]

Omitting to amend the opening wording of subsection 149.1(1.1) appears to be an oversight in that the subsection still refers to “gifts made to a qualified donee” rather than the updated language used in paragraphs 149.1(2)(b), (3)(b), and (4)(b) that now refers to “gifts made by [a charity] that are qualifying disbursements.”

Second, the CRA does not provide much guidance about how charities should calculate which expenditures are used in administration and management of the charity. Charities will have to be diligent to document all administration and management expenditures, including any amounts that may be allocated on a percentage basis (*e.g.*, if a person spends 50% of their time on administration or management, then 50% of their salary will need to be allocated as an administration or management expense). Failure to keep adequate books and records is sufficient grounds for the Minister of National Revenue to revoke a charity’s charitable status.

In the context of fundraising, by analogy, the CRA has provided guidance about allocation of fundraising expenses by stating the following:

116. Where a charity can demonstrate that an activity would have been undertaken without the fundraising component, it may allocate 100% of the costs to charitable, management and administration, or other expenditures, as applicable. The fundraising content is considered to be ancillary and incidental to the other activity or activities.

117. To show that an activity would have been undertaken without the fundraising component, charities must satisfy the substantially all test. The CRA will consider that an activity would have been undertaken without the fundraising component if substantially all of the activity advances an objective or objectives other than fundraising. For the purposes of this test, substantially all is considered to be 90% or more. During the course of an audit or other review, the onus is always on the charity to show that an activity meets the substantially all test.<sup>10</sup>

Without further guidance from the CRA, many questions remain, such as whether a charity would be able to follow similar allocation rules as those found in the fundraising guidance if an employee, for example,

---

<sup>10</sup> CRA, Guidance CG-013 “Fundraising by registered charities” (issued 20 April 2012, date modified 10 May 2019), online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/fundraising-registered-charities-guidance.html>> at para. 116-117.

spent 90% of their time engaged in carrying out the charitable activities for the charity, and 10% of their time doing administrative work; and whether a charity could claim that substantially all of the work was charitable. It is hoped that a similar standard would be applied in the case of administrative and management cost allocations, so that charities do not have to meet multiple allocation standards depending on the context. Regardless, if charities are calculating what portions of an expense should be allocated to administration and management and what portions should be charitable expenses, they will need to keep detailed books and records recording this process and to demonstrate that any allocation undertaken was reasonable.

### c) Other Changes to the DQ

There are several other technical changes to the DQ in the draft legislation.

- Subsection 149.1(5) is proposed to be amended to allow CRA to deem a charity's DQ obligation to be reduced. Currently, subsection 149.1(5) allows the CRA to reduce the disbursement requirements of that charity for a particular year by deeming a specified amount to be an amount expended by the charity in the year on charitable activities carried on by it. Generally, this reduction is only granted where a charity has failed to meet its DQ obligation for circumstances beyond its control and only after it has used up any DQ excess or other measures. The explanatory notes accompanying the draft legislation indicate that the new DQ reduction mechanism is intended to improve transparency with respect to charities that have a reduction to their DQ and to better reflect actual expenditures on charitable activities.
- A new paragraph 241(3.2)(i) is proposed to be inserted permitting the CRA to release information when a charity has requested its DQ obligation be reduced under subsection 149.1(5), and any response to that application. Whether this means such decisions will be made available on the CRA's online charities listing, or whether it can be requested under subsection 241(3.2) of the ITA (similar to information filed to support requests for permission to accumulate property), remains to be seen.
- Subsection 149.1(8) concerning accumulation of property is proposed to be repealed. Subsection 149.1(8) currently allows charities to apply for permission to accumulate property and is intended to assist a charity that is finding it difficult to meet its disbursement quota for a particular reason, such as accumulating capital for a building program. The repeal of subsection 149.1(8) means that charities

would no longer be able to accumulate property such that the amount accumulated would satisfy their DQ obligation.

- Paragraph 149.1(4.1)(d) is proposed to be amended to ratify a typo in Bill C-19 which incorrectly referred to “qualified disbursements” instead of “qualifying disbursements.”

Notwithstanding the above changes to DQ-related provisions in the ITA, the rule regarding disbursement excess in subsections 149.1(20) and (21) remains the same.

All of the proposed changes to the rules regarding the DQ in the draft legislation would come into force on January 1, 2023, except for the amendment to the typo in 149.1(4.1)(d), which would be deemed to have come into force on June 23, 2022.

## C. UPDATED REPORTING REQUIREMENTS FOR TRUSTS

There may soon be changes to the reporting requirements for trusts in Canada if the draft legislation comes into force. As previously covered in the *February 2022 Charity & NFP Law Update*,<sup>11</sup> Finance Canada had released a set of draft legislative proposals and accompanying explanatory notes on February 4, 2022, with proposed changes requiring more trusts to file a return of income (“T3”). Those changes were originally proposed in the federal budget of February 27, 2018, and contained draft legislation and regulations released on July 27, 2018. Then the same changes were released on February 4, 2022, where the implementation of the proposals is deferred by one year, applicable to taxation years ending after December 31, 2022, instead of the December 31, 2021 taxation year as previously proposed. Those February 2022 proposed changes are again contained in the draft legislation released on August 8, 2022, with some minor changes in the recent draft legislation.

Subsection 150(1) stipulates the tax return requirements and the filing dates for different categories of taxpayers. Subsection 150(1.1) sets out exceptions to subsection 150(1), where the filing of a tax return is not required. Subsection 150(1.1) is proposed to be amended to make it subject to the new subsection 150(1.2), which provides that the exception from filing a trust T3 return would not apply to an “express trust”, or for civil law purposes a trust, other than a trust that is established by law or by judgement, that

---

<sup>11</sup> Terrance S Carter, *February 2022 Charity & NFP Law Update*, “Legislation Update” (24 February 2022) online: Carters Professional Corporation <[https://www.carters.ca/index.php?page\\_id=458](https://www.carters.ca/index.php?page_id=458)>.



is resident in Canada, unless the trust meets one of the exceptions outlined in new paragraphs 150(1.2)(a) to (o). While paragraphs (d) and (e) exempt an “express trust” that is a registered charity, or a club, society or association described in paragraph 149(1)(l) (*i.e.*, non-profit organization) from filing a T3, these exceptions do not, on the face of the proposed ITA wording, apply to internal trusts of charities that are set up as express trusts (such as endowment funds set up by a deed of trust by donors).

The CRA has a long-standing administrative policy that it does not require internal trusts of charities to file separate trust returns. The proposed legislation, however, is not consistent with this long-standing policy and may cause confusion by not clearly exempting internal trusts of charities that are set up as express trusts from filing separate T3s. Such a change would be highly problematic because certain charities, especially larger charities such as universities which may hold thousands of endowments, would face much higher administrative costs and time pressures if a return needed to be filed for each trust the charity held.

The list of exemptions in subsection 150(1.2) includes a trust that is a registered charity or a non-profit organization. In this regard, it is important that charities understand that there is a difference between a charity holding property internally in trust and a charity organized as a trust. Many charities hold property in trust (*e.g.*, a gift from an estate may be a charitable purpose trust in the form of an endowment, and it is possible that a charity may have multiple of these types of internal trusts in place) but few charities are themselves organized as trusts. Because the scope of the proposed subsection 150(1.2) is so broad in that it applies to all express trusts resident in Canada unless a trust fits into a list of very specific exceptions, there may be limited situations in which a charity that holds property in trust internally will be exempt from T3 reporting requirements. Hopefully the CRA will provide confirmation that the current administrative position of the CRA concerning internal trusts will not change notwithstanding what is proposed in subsection 150(1.2) of the draft legislation. Charities that hold property in trusts internally, such as endowments, will want to carefully follow the development of this legislation and be aware of potential T3 reporting requirements that could come into force.

There are also other proposed changes to the Regulations, such as the insertion of the new section 204.2 to require all fiduciaries of a trust provide certain information, including the names, addresses, dates of birth, jurisdiction of residence and taxpayer identification numbers (“TINs” as defined in subsection 270(1)) of each person that is a trustee, beneficiary, or settlor of the trust. Fiduciaries will also be required



to provide that same information for any person who has the ability to exert influence over trustee decisions regarding the appointment of income or capital of the trust.

The draft legislation also includes new subsection 150(1.3) requiring “bare trusts” to be subject to trust reporting requirements as well as section 204.2 of the Regulations. These are “arrangement where a trust can reasonably be considered to act as agent for its beneficiaries with respect to all dealings in all of the trust’s property.” It is important for charities and non-profit organization that have entered into bare trust arrangements to be aware of the application of the new filing requirements

These changes are proposed to apply to taxation years that end after December 30, 2022. This means that the new filing requirement will apply to entities with fiscal years ending on or after December 31, 2022.

#### **D. CHARITIES MAY BE BENEFICIARIES OF NEW FIRST HOME SAVINGS ACCOUNT**

The draft legislation proposes to add a new section 146.6 to the ITA that provides the general tax framework for first home savings accounts (“FHSA”). While the majority of the provisions regarding FHSA will not be directly relevant for charities, the circumstances in which a charity or other qualified donee may be a beneficiary of an FHSA will likely be relevant.

Under subsection 146.6(1) of the proposed provision, a beneficiary is defined as follows:

beneficiary under a FHSA means an individual (including an estate) or a qualified donee that has a right to receive a distribution from the FHSA after the death of the holder of the FHSA.

Therefore, a charity, as a qualified donee, will have the right to receive a distribution from an FHSA in the limited circumstance of the passing of the individual who holds the FHSA. Proposed subsection 146.6(11) provides that the amount distributed shall be included in the beneficiary’s income for the year. These changes are proposed to come into force as of January 1, 2023.

#### **E. OTHER UPDATES**

There are a few additional updates in the draft legislation, the majority of which apply to registered charities, registered Canadian amateur athletic associations (“RCAA”) and registered journalism organizations (“RJO”).

1. Paragraph 149.1(15)(a) provides that, notwithstanding section 241, the CRA may share prescribed information that is required to be contained in the public information return by registered charities, RCAAAs or RJOs. Paragraph 149.1(15)(a) is proposed to be amended to allow the CRA to share that information whether or not the public information return was filed by the required date.
2. Paragraph 149.1(15)(b) provides that, notwithstanding section 241, the CRA may make available to the public, in any matter deemed appropriate, certain information relating to registered or previously registered charities, RCAAAs, RJOs and qualified donors. Subparagraph 149.1(15)(b)(iii) provides that the CRA may provide the effective date of the revocation, annulment or termination of these entities. Subparagraph 149.1(15)(b)(ii) is proposed to be amended to allow the CRA to also provide the effective date of any suspension of these entities.
3. Subsection 189(6.1) of the ITA requires a charity that is liable for a revocation tax under subsection 188(1.1) to file a return within one year from the date of issuance of either a certificate issued under the *Charities Registration (Security Information) Act* or a notice of intention to revoke the registration of a charity issued by the CRA. The revoked charity must file the return without notice or demand, and must estimate and pay the tax payable. Subsection 189(6.1) is proposed to be amended to require the return be filed when the charitable registration is revoked, instead of when the revoked charity is liable for a revocation tax under subsection 188(1.1). However, the revoked charity will not have to file where the CRA has notified the charity that the intention to revoke has been abandoned under subsection 188(2.1).
4. Subsection 189(8) provides that certain provisions of the ITA apply in respect of an amount assessed under Part V of the ITA and also apply in respect of a notice of suspension for issuing official donation receipts under subsection 188.2(1) or (2) as if the notice of suspension were a notice of assessment made under section 152. Subsection 189(8) is proposed to be amended by the addition of a reference to subsection 188.2(2.1), making subsection 189(8) applicable to a notice of suspension issued pursuant to 188.2(2.1).
5. Section 3504 of the Regulations sets out the entities that qualify as “prescribed donees” for the purposes of subparagraphs 110.1(2.1)(a)(ii) and 118.1(5.4)(a)(ii) of the ITA in relation to gifts of certain real property situated in Canada by non-residents to prescribed donees. Regulation 3504

currently prescribes Friends of the Nature Conservancy of Canada, Inc., the Nature Conservancy, and American Friends of Canadian Land Trusts for these purposes. The prescribed donee must provide an undertaking in a form satisfactory to the CRA to the effect that such property will be held for use in the public interest. Paragraph 3504(a) is updated as a consequence of successive changes to the name of the referenced charity in the United States of America. Effective December 7, 2015, the charity became known as American Friends of Nature Conservancy of Canada, Inc., and, on October 16, 2018, as Friends of the Nature Conservancy of Canada, Inc.

All of the above proposed amendments will come into force in respect of taxation years that end after the announcement date of August 9, 2022, except for the amendment of subsection 189(8) which will be deemed to have come into force on the announcement date.

## F. CONCLUSION

The draft legislation, in its current form, may be amended before it is introduced in the House of Commons or as the legislation progresses through the House and the Senate. Nevertheless, these proposed provisions anticipate several changes which will significantly affect charities if they become law. Most importantly, charities should begin to plan how they might invest their resources to meet a higher DQ rate or possibly plan to meet the new trust reporting guidelines. While some of the technical announcements regarding trust returns and information returns may seem very specific, they are, nevertheless, updates that will affect most charities, and are, for that reason, important to be aware of.