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### A Deeper Dive into QDs and DQs: Qualifying Disbursements and Disbursement Quota Regimes

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#### Introduction

- Unlike a DQ Sandwich from Dairy Queen that is predictable and generally satisfying, the murky and evolving world of QDs (Qualifying Disbursements) and DQs (Disbursement Quota Rules) is neither predictable nor very satisfying
- This session will explain a number of the key aspects concerning the complexities, challenges and interrelationships associated with:
  - The New Qualifying Disbursement Regime and its Practical Implications; and
  - The Increased Disbursement Quota Regime, Changes and Challenges



## I. The New Qualifying Disbursement Regime and its Practical Implications

### A. Background and Overview to the New Regime

#### 1. Setting the Stage

- Implementing effective gift planning requires a working knowledge of what charities can and cannot do with the funds that they raise
- In this regard, many charities may need to work with other organizations from time to time in order to achieve their charitable purposes
- When those other organizations are Canadian registered charities or other types of qualified donees (“QD”) listed in the *Income Tax Act* (“ITA”), it is possible to do so because a Canadian registered charity is able to make gifts to other QDs
- However, when a charity is wanting to work with an organization that is not a qualified donee (“Non-QD”), compliance issues become more challenging
- Examples of charities working with Non-QDs could include:

- A charity wanting to fund a community social assistance program run by a community organization that is a Non-QD

- A hospital foundation with broad community purposes wanting to make a grant to a local indigenous healthcare organization that is a Non-QD

## 2. Before Bill C-19 Amended the ITA on June 23, 2022 – “Own Activities Regime”

Canadian registered charities could only use their resources in one of two ways under the ITA:

1. Making gifts to qualified donees (“QDs”)

2. Conducting their own activities by devoting their resources to charitable activities carried on by their own staff and volunteers or through intermediaries under direction and control (“Own Activities Regime”)

If a charity wanted to work with an organization that was not a QD, it had to demonstrate that it was conducting its own activities by exercising direction and control over the Non-QD organization concerning how it utilized any funds or other resources provided by the charity

### 3. Bill C-19 Introduced the New Option of Qualifying Disbursement Regime

- As a result of amendments to the ITA on June 23, 2022 (Bill C-19), there is now a new option of making qualifying disbursements to Non-QDs in the form of either a “gift” or “otherwise making resources available” as discussed below (“Qualifying Disbursement Regime”)
- The CRA describes this as making a “grant” to a Non-QD
- CRA released a draft guidance on November 30, 2022 (“Draft Guidance”), followed by the release of its final guidance on December 19, 2023, [CG-032 Registered charities making grants to non-qualified donees](#) (“Final Guidance”)
- This presentation reviews the following:

– What the new Qualifying Disbursement Regime Involves

– A Selection of Key Aspects of the Final Guidance

– Issues to Consider in working with the Qualifying Disbursement Regime

– How the New Qualifying Disbursement Regime Compares to the Own Activities Regime

### 4. After Bill C-19 Became Law on June 23, 2022

- Canadian registered charities now have two regimes to choose from as graphically depicted in the Final Guidance:



- Essential to reference to the actual ITA wording

ss. 149 (1) of ITA "qualifying disbursement means a disbursement by a charity, by way of a gift or by otherwise making resources available,

(a) subject to subsection (6.001), to a qualified donee, or

(b) to a grantee organization, if

- (i) the disbursement is in furtherance of a charitable purpose (determined without reference to the definition charitable purposes in this subsection) of the charity,
- (ii) the charity ensures that the disbursement is exclusively applied to charitable activities in furtherance of a charitable purpose of the charity, and
- (iii) the charity maintains documentation sufficient to demonstrate (A) the purpose for which the disbursement is made, and (B) that the disbursement is exclusively applied by the grantee organization to charitable activities in furtherance of a charitable purpose of the charity;"

"grantee organization" includes a person, club, society, association or organization or prescribed entity, but does not include a qualified donee;

## B. A Selection of Key Aspects from CRA Final Guidance

- The following is a selection of key aspects from the Final Guidance
- It is essential to read the Final Guidance, though, as it represents a significant rewrite of the former Draft Guidance

### 1. Section 1: Background and Approach by the CRA

- The Final Guidance provides background information in relation to its use by stating that "[t]his guidance is not law"
- This is helpful for those in the charitable sector who do not have a legal background and may otherwise assume that a guidance from the CRA is a statement of the law
- The reality, though, is that CRA's recommendation in the Final Guidance will become "de facto law" because there is nothing else to guide a charity on what a qualifying disbursement involves
- The Final Guidance states that the CRA's aim is to adopt a "reasonable, flexible and proportionate" approach to documenting granting, which statement could prove to be helpful in a CRA charity audit

## 2. Section 3: Due Diligence Review

- CRA recommends the following “due diligence” steps be taken by charities who wish to make grants:

### 3.1: Establish how the grant activity furthers the charity’s charitable purpose

- A charity’s grant activity must further at least one of its own charitable purposes as set out in its own governing documents, *i.e.* a grant by a charity which furthers any charitable purpose more generally (but is not one of the charity’s own purposes) is not sufficient to be a legitimate grant under the Qualifying Disbursement Regime

### 3.2: Assess the grant’s risk level

- The Final Guidance sets out a risk matrix of low, medium and high risk that is intended to help as a guideline to explain risk factors a charity should consider, although the listed factors are described as “non-exhaustive”
- The factors set out in the risk matrix include: (1) the charity’s experience, (2) the grantee’s experience, (3) purposes and governing documents of the grantee organization, (4) governance structure of the grantee organization, (5) the grantee’s regulation and oversight, (6) private benefit concerns, (7) grant activity, (8) grant amount, (9) nature of resources granted, and (10) grant duration

### 3.3: Determine how much due diligence the charity needs to apply through accountability tools based on the risk level

- The Final Guidance provides an additional risk matrix which contains guidelines to help a charity determine whether the use of accountability tools where there is a low risk, a medium risk, or a high risk situation
- These accountability/risk assessment tools include (1) research and review of each grantee (such as grantee’s staff and reputation of the grantee), (2) description of grant activity, (3) written agreement, (4) reporting plan, (5) transfer schedule, and (6) separately tracked funds

### 3.4: Apply the accountability tools in collaboration with grantee

- Charities are encouraged to work together with grantees to ensure that the accountability requirements set out in the Final Guidance are met

### 3.5: Document the charity’s due diligence over the grant’s duration

- Charities are reminded that they are required under the ITA to keep adequate books and records, which contain sufficient information to allow CRA to determine whether:
  - The charity’s grants meet the accountability requirements,
  - The grantee’s use of the charity’s resources can be verified through appropriate supporting documentation, and
  - The grantee continues to use the granted resources for the purposes and activities set out in the grant’s terms

## C. Issues to Consider When Making Qualifying Disbursements

### 1. Defined Terms of “Grants” & “Grant Making” Not in the ITA

- The Final Guidance states that it focuses “on making grants to grantees”, but the terminology of “grants” and “grant making” are not terms that are used in the ITA
- The ITA uses the terms “qualifying disbursement” and “grantee organizations”

Language in ITA	Language in Final Guidance
<p><b>qualifying disbursement</b> means a <u>disbursement</u> by a charity, by way of a <u>gift</u> or by <u>otherwise making resources available</u> to a qualified donee, or a <u>grantee organization</u></p>	<p>“<b>grant</b>” refers to a “<u>qualifying disbursement</u>” made to a “grantee organization”, as defined in the ITA. A grant can include both <u>cash and non-cash resources</u>. While the term “grant” is commonly applied to other arrangements within the charitable sector, <u>this guidance uses the term “grant” in relation to the ITA requirements</u> for making a “qualifying disbursement” to a “grantee organization”</p>

- Courts expect charities to comply with legislation rather than to a CRA guidance, so these differences are important to keep in mind, as they could have significance on a CRA audit that was subsequently reviewed by a court
- Definition of “grant” does not explain that it needs to include both “gift” and “otherwise making resources available” for both cash and non-cash gifts to Non-QDs

## 2. Need to Review Charitable Purposes of the Charity

- A qualifying disbursement is about furthering the charitable purpose of the disbursing charity and cannot be done if it is outside of the disbursing charity’s own charitable purposes
- Therefore, it is essential to review the charitable purposes of the disbursing charity before considering making a qualifying disbursement
- Foundations that have only a single purpose of making gifts to QDs will not be able to make qualifying disbursements to grantee organizations, e.g. Non-QDs, since grantee organizations are not QDs
  - As such, foundations with a single purpose of only making gifts to QDs will need to review and expand their charitable purposes if they are intending to make qualifying disbursements to Non-QDs

### 3. The Imposition of Additional Requirements Not in the ITA

"Risk" is mentioned **31 times** in the Final Guidance (down from 62 times in the Draft Guidance) but is not mentioned at all in s. 149.1 of the ITA

Use of a risk matrix is very similar to onerous Financial Action Task Force (FATF) and US Treasury Risk Matrix for purpose of anti-terrorist financing avoidance

Significant Focus on Risk and Due Diligence

Risk matrix says that grants outside Canada and over \$50,000 are high risk but no explanation is provided to explain why \$50,000 is a high risk threshold

While CRA recommends using the "due diligence model", "due diligence" is not mentioned in s.149.1 of the ITA at all

#### Extensive Accountability Requirements

- "Accountability" is mentioned **66 times** in the Final Guidance, up from 46 times in the Draft Guidance, but is not mentioned at all in section 149.1 of the ITA
- "Accountability requirements" and "accountability tools" are defined as part of the "due diligence" needed in the Final Guidance
  - "due diligence" is defined as "steps taken to satisfy the legal requirements for granting under the Income Tax Act" through accountability tools
  - "accountability tools" are defined as due diligence measures to meet accountability requirements
  - "accountability requirements" refer to ITA requirements for making a grant
- Suggested accountability tools are similar to the requirements for "expenditure responsibility" for US private foundations, which are complicated
- The accountability tools are similar to the onerous requirements that were in the proposed ITA regulations but were removed from Bill C-19 when adopted
- The accountability requirements of the Qualifying Disbursement Regime are more onerous from a practical stand point than the direction and control requirements of the Own Activities Regime

### Pooled Grants with Multiple Organizations

- Before a charity can make a pooled grant with one or more Non-QDs, the Final Guidance recommends the charity must sign onto at least one written agreement with all parties (“ideally”, or if not feasible, then other accountability arrangements may be acceptable), along with interim and final reports
- Otherwise, the Final Guidance recommends approaching pooled grants cautiously
- In light of this, charities may be hesitant to make pooled grants because of the complexity and risk involved

### Charitable Goods

- Charitable goods (*i.e.* goods that can only reasonably be used for charitable purposes, such as medical supplies) are subject to specific “accountability tools”, including written agreements and final reports on how goods were used
- These requirements are more onerous than for “charitable goods” under the direction and control regime in CRA’s CG-002 Guidance, [Canadian registered charities carrying on activities outside Canada](#)

#### 4. Unclear Explanation of “Otherwise Making Resources Available”

- The ITA does not explain what the phrase “otherwise making resources available” means in practice
- The Final Guidance does not mention “otherwise making resources available” except as part of the definition of “qualifying disbursement” in the ITA
- In the CRA’s [Guidance on Fundraising \(CG-013\)](#), “resources” are defined in paragraph 27 to include “everything the charity can use to further its purposes, including financial assets, staff, volunteers, directors, time, property, premises, facilities and equipment”
- There are two possible interpretations concerning what the phrase “otherwise making resources available” could mean in practice
  - The charity is gifting non-monetary “resources” to a Non-QD or
  - The charity is making available monetary (e.g. loans) and non-monetary “resources” to a Non-QD, such as use of space, staff, administration services, volunteers, use of branding, loans, including impact investing
  - Given the use of “otherwise”, the second approach is likely correct
- This unclarity will be important to consider with regards to the calculation of the disbursement quota referenced below, as only “gifts” to QDs and Non-QDs count towards meeting the disbursement quota

## 5. Some Qualifying Disbursements Do Not Meet Disbursement Quota (“DQ”) Obligations

- Only qualifying disbursements that are gifts to QDs and Non-QDs can be used to meet the DQ obligations of the disbursing charity
  - Many charities may find this confusing to track or difficult to comply with in light of the increased DQ of 5% for investment property in excess of \$1 million
- Qualifying disbursements made by “otherwise making resources available” to either QDs or Non-QDs will not be counted towards the DQ, which means that making space, staff and volunteers available, as well as engaging in loans, micro-finance loans and other types of impact investing are not DQable
- The Final Guidance mentions that “[f]or reporting purposes, and to help the charity meet its disbursement quota, the charity must be able to determine the fair market value of non-cash grants”, which would include “otherwise making resources available” when a gift is not involved
- However, the Final Guidance does not provide an explanation of what this determination process would involve
- As well, schedule 8 to the T3010-24 about meeting the DQ includes the term “grants”, which is broader than “gifts” to QDs and Non-QDs, therefore creating confusion

## 6. Does Not Reflect The Actual Wording in ITA About Directed Gifts

- New paragraph 168(1)(f) of the ITA states that CRA can revoke a charity’s charitable registration if it “accepts a gift “the granting of which was expressly or implicitly conditional on the charity [...] making a gift to another person, club, society, association or organization other than a qualified donee””
  - e.g. Charity A accepting a gift that is “expressly or implicitly conditional” on Charity A making a gift to a Non-QD
- The Final Guidance states that paragraph 168(1)(f) of the ITA is intended “to prevent organizations from acting as conduits in the making of a directed gift” to a Non-QD, and refers to the Explanatory Notes from Finance to Bill C-19
- However, there is no explanation in the Final Guidance concerning what a “conduit” is or what “acting as conduits” mean other than to recommend that a charity should retain “authority over the use of its resources, and clearly communicate this to the donors”, for example communicating that:
  - Ultimate authority over the donation rests with the charity
  - If donor preference for the gift is not met, charity will not return the gift

- Conditional gifts, though, have a particular meaning at common law that is not referenced in the Final Guidance
- The Final Guidance uses an example to explain what “expressly conditional” gifts are, which correctly includes a right of reversion to the donor if the condition is not fulfilled
- However, the Final Guidance is not clear what an “implicitly conditional” gift is when it gives as an example a charity that has the name of a Non-QD in its name, purposes, or other formal documents but no right of reversion
- The interpretation of directed gift in the Final Guidance could limit the fundraising abilities of charities involved in grants to Non-QDs
- The Final Guidance, though, states that the directed gift provision does not apply to a charity carrying out its own activities through an intermediary under the charity’s direction and control, presumably because this does not involve the receiving charity making a “gift”
- This could result in charities being reluctant to use the Qualifying Disbursement Regime when public fundraising is required

## 7. Qualifying Disbursement Limits for Charitable Organizations

### a) Subsection 149.1(6.001) of the ITA – Qualifying Disbursement Limit

#### 149.1 (6.001)

In any taxation year, disbursements of income of a charitable organization by way of gifts to a qualified donee (other than disbursements of income to a registered charity that the Minister has designated in writing as a charity associated with the charitable organization) in excess of 50% of the charitable organization’s income for that year are not qualifying disbursements.

b) Consequences of subsection 149.1(6.001) of the ITA

- This qualifying disbursement limit:
  - Only applies to the income of a charitable organization, not to a public or private foundation
  - Does not apply to gifts of capital, but there remains the challenge of distinguishing between what is income and what is capital
  - Only applies to gifts to qualified donees, therefore, does not apply to
    - Gifts to grantee organizations (*i.e.* Non-QDs), or
    - To “otherwise making resources available”, such as making available space, staff, volunteers or loans
- If the excess is not deemed a qualifying disbursement, then what is it?
  - Presumably the excess disbursement of income could result in revocation of charitable status under paragraph 149.1(2)(c) of the ITA
  - Most likely would result in the charity being redesignated as a public foundation by CRA

#### D. Reporting Qualifying Disbursements

- Regulation 3703 under the ITA state that a charity that makes a qualifying disbursement to a grantee must include on its annual return (*i.e.* Form T3010) the following information for each grantee organization that receives in excess of \$5,000 in the taxation year:
  - a) The name of the grantee organization;
  - b) The purpose of each qualifying disbursement; and
  - c) The total amount disbursed by the charity to each grantee organization
- In May 2023, the CRA updated the [T3010 Registered Charity Information Return](#) to report grants made to Non-QDs and introduced the new [T1441 Qualifying Disbursements: Grants to Non-Qualified Donees](#) requiring detailed information about these grants
- The T1441 states that the charity must be able to determine the fair market value of non-cash disbursements (*e.g.* use of space and staff) that are made to grantees
- These Forms were further updated on January 8, 2024 and charities must ensure that the correct version of Form T3010 is filed depending on it fiscal year end – for a more detailed commentary, see [Charity & NFP Law Bulletin No. 525](#)

- Form T3010 asks:

- If the charity has made qualifying disbursements via “grants” to Non-QDs
- If any of these “grants” totaled more than \$5,000 in cash and non-cash grants in one fiscal period
- The number of grantees receiving grants totaling \$5,000 or less
- Total amount paid to grantees totaling \$5,000 or less in a fiscal period
- The new Form T3010 (v. 24) also asked for the total value of qualifying disbursements from donor advised funds in a fiscal period

- Form T1441, which records all grants individually, must include

- The number of grantees that received grants totaling more than \$5,000
- Report each grant separately, even if it’s to the same grantee
- The name of the grantee
- The purpose of the “grant”
- The total amount of cash and non-cash disbursements at FMV separately
- The country and country code of where grant activities were carried out, (unless permission is obtained due to safety concerns)

## E. Comparing the Qualifying Disbursement Regime to the Own Activities Regime

- Since registered charities can now choose between two regimes when working with Non-QDs, what are the differences?

Own Activities Regime	Qualifying Disbursement Regime
1. Focus on the charity being the <u>directing mind</u> with an intermediary <u>carrying out instructions</u> received from the charity	1. Focus on <u>supporting the activities of the grantee organization</u> but only in furthering a charitable purpose of the donor charity
2. More of a <u>hierarchical top down</u> relationship	2. More of a <u>collaborative relationship</u>
3. The funds or resources are <u>not gifted</u> , instead they are transferred to an intermediary as <u>an extension of the charity</u> by means of a contractual agreement	3. The funds or resources are <u>either gifted or are otherwise made available</u> to the grantee, allowing the grantee autonomy to carry on its programs as an independent party
4. The applicable <u>regulatory due diligence</u> is in the form of <u>ongoing direction and control</u> by the charity over the activities of the intermediary	4. The applicable <u>regulatory due diligence</u> is in the form of <u>applying risk matrices</u> and following <u>extensive accountability requirements</u> rather than providing ongoing direction and control

Own Activities Regime	Qualifying Disbursement Regime
5. An <u>agreement is needed</u> to reflect <u>direction and control</u> over own activities of the charity e.g. contract for service or co-operative participation	5. For qualifying disbursements <u>above \$5,000 (or below but expected to be made on an ongoing basis)</u> , a <u>grant agreement is recommended</u> to address a significant degree of risk assessment and accountability requirements
6. As the intermediary is acting as an <u>extension of the charity</u> under the direction and control of the charity, the charity <u>may be exposed to liability</u> by the intermediary	6. Grant arrangement could <u>avoid the unintended consequences</u> for a charity carrying on its <u>own activities through an intermediary</u> , such as incurring liability to third parties under an agency relationship
7. Charitable programs done through an intermediary <u>will count toward the disbursement quota</u> of the charity	7. Qualifying disbursements in the form of " <u>otherwise making resources available</u> " <u>will not count towards the disbursement quota</u> of the charity
8. Contracting with an intermediary to allow the intermediary <u>to purchase land</u> is subject to <u>significant restrictions</u>	8. <u>Gifting of real estate</u> should be carefully documented but is generally <u>less restrictive</u>
9. Contracting with an intermediary in Canada " <u>may</u> " attract HST/GST (need expert HST advice)	9. Making a qualifying disbursement to a grantee in Canada <u>will not attract HST/GST</u> (need expert HST advice)
10. <u>Less onerous</u> reporting requirements in Form T3010	10. <u>More onerous</u> reporting requirements in Form T3010 and Form T1441

## F. Key Takeaways



The new Qualifying Disbursement Regime is an important new option for registered charities to consider



However, there are complexities and significant due diligence requirements that must be carefully reviewed before deciding to make a qualifying disbursement to a grantee organization



Whether or not a registered charity should embark on making a qualifying disbursement to a grantee organization or choose to continue with the Own Activities Regime is a decision that should be carefully reviewed with legal counsel for the registered charity



It is important to stay up to date for any changes that the CRA may implement to the reporting requirements in Form T3010 and possible updates from the CRA on the Final Guidance, as the Final Guidance is intended to be an "evergreen" document

## G. Resource Materials for Qualifying Disbursements

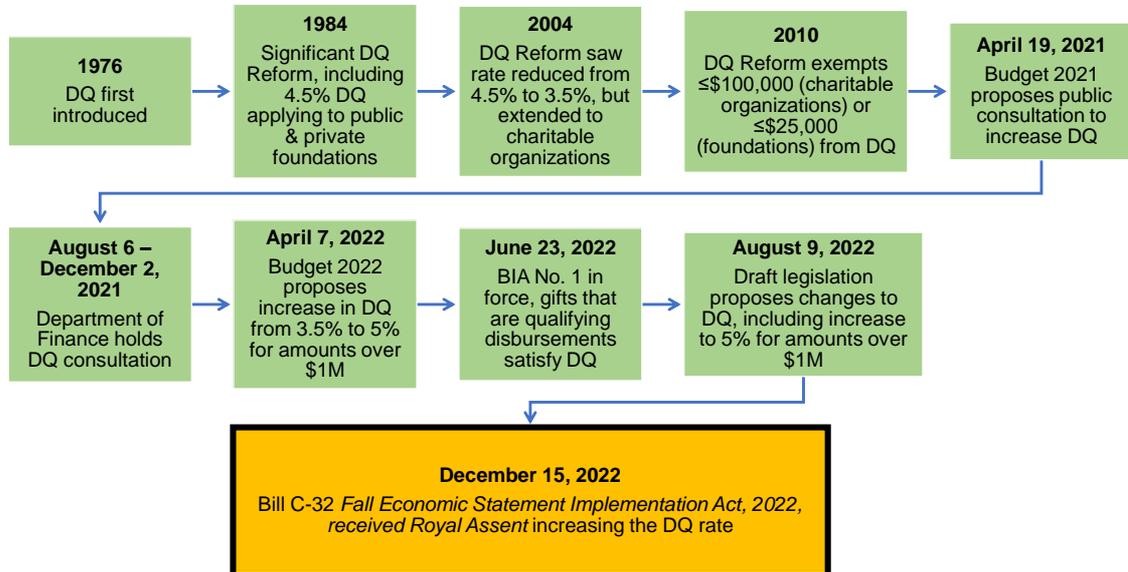
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## II. The Increased Disbursement Quota Regime, Changes and Challenges

### A. What is the Disbursement Quota?

- Disbursement Quota (“DQ”) is the minimum amount that a charity must spend on its own charitable activities or qualifying disbursements (including “gifts” to qualified donees and grants to non-qualified donees)
- DQ is to ensure that charitable assets are used for charitable purposes and are not simply accumulated indefinitely by charities
- It is a requirement under the ITA
- DQ applies to all charities but is of particular relevance to foundations and other charities that have investment assets that are not being used directly in charitable activities or administration (such as endowments or portions of buildings that are surplus and are rented out)
- The purpose of the DQ:
  - Limits excess becoming undue capital accumulation
  - Ensures that non-charitable resources are used for charitable programs

## B. History and Timeline of DQ



## C. New Changes to the DQ Introduced on January 1, 2023

### 1. Increase in DQ

- As a result of sector wide consultations in 2021, the 2022 Federal Budget announced that the DQ would be increased to 5% for amounts in excess of \$1 million
- *Economic Statement Implementation Act, 2022* (“Bill C-32”) received Royal Assent on December 15, 2022
- Amended the ITA to increase the DQ rate from 3.5% to 5% for property held by a charity in excess of \$1 million that is not used directly in charitable activities or administration
- The increased DQ applies to taxation years beginning on or after January 1, 2023

### Chart Showing Various DQ Scenarios as of January 1, 2023

Types of Charity and Value of Property* Held by the Charity	Former DQ Obligation	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	<b>\$35,000+ 5% of the amount of property which exceeds \$1M</b>
Charitable organization with >\$1,000,000 of property	3.5% of property	<b>\$35,000+ 5% of the amount of property which exceeds \$1M</b>

\* "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

## 2. Exclusion of Administration and Management Expenses

- Bill C-32 added paragraph (d) to ss 149.1(1.1) of the ITA to provide that administration and management expenditures are deemed not to satisfy the DQ

## 3. DQ Obligation Reduction

- Prior to Bill C-32 coming into force, ss 149.1(5) of the ITA allowed the CRA, upon application, to deem a specified amount expended by a charity to be an amount expended by a charity on its own charitable activities in satisfaction of the DQ
- Bill C-32 amended ss 149.1(5) to allow the CRA to instead deem a charity's DQ obligation to be reduced upon application by the charity
- A DQ reduction is available to charities whose expenditures on charitable activities or qualifying disbursements are less than required in the year to meet the DQ due to circumstances beyond its control that are specific and not general in nature
- Bill C-32 also amended the ITA to allow the CRA to release information to the public pertaining to the changing application to reduce the DQ obligation under ss 241(3.2)
- Written approval to accumulate property prior to January 1, 2023 is still valid until the approval period expires

## D. Calculating DQ

- Rules for calculating the DQ are set out in the ITA, with detailed calculation in Income Tax Regulations 3701, and 3702

### 1. Property to be Included

- Property not used directly in charitable activities or administration of the charity
  - For example - cash, investments, inventory, stocks, bonds, mutual funds, GICs, land, and buildings
  - For buildings that are being used for non-charitable activities, “then that portion should be pro-rated and included in the calculation”, which can be challenging
  - If permission was granted by CRA on or before December 31, 2022 to accumulate funds, the accumulated amount is excluded from the asset base

### 2. Time Frame for Calculation of DQ Obligation

- DQ calculation applies for the preceding 24 months (*i.e.*, the 24 months immediately preceding the taxation year)
  - For example, assume year end December 31, then DQ for 2024 is based on January 1, 2022 to December 31, 2023

### 3. Calculate Average Value in Time Frame

- Determine the “average value” of the property of the 24 month period by over 2 to 8 periods
- Charity to choose number of periods to calculate the “average value” of property
- To be chosen when the charity files its first information return
- Future changes of the number of periods requires CRA approval

	Jan. 1 to Dec. 31, 2022	Jan. 1 to Dec. 31, 2023	Current fiscal year Jan. 1 to Dec. 31, 2024
Example of # of periods	24 months before the fiscal year in question		Calculate DQ 3.5% or 5% on the base value
2 periods ( <i>i.e.</i> annually)	FMV as of Dec. 31, 2022	FMV as of Dec. 31, 2023	Add the 2 FMV numbers and divide by 2
4 periods ( <i>i.e.</i> semi- annually)	FMV as of June 30 and Dec. 31, 2022	FMV as of June 30 and Dec. 31, 2023	Add the 4 FMV numbers and divide by 4
8 periods ( <i>i.e.</i> quarterly)	FMV as of Mar. 31, June 30, Sep. 30, Dec. 31 2022	FMV as of Mar. 31, June 30, Sep. 30, Dec. 31, 2023	Add the 8 FMV numbers and divide by 8

#### 4. Meeting DQ Obligation



Only these expenditures can be used to meet the DQ obligation

- Funds spent by a charity on its charitable activities
- Qualifying disbursements on gifts to qualified donees and non-qualified donees



Only include “Gifts” to QDs and Non-QDs

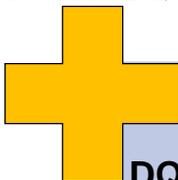
- Does not include Qualifying Disbursements that consist of “otherwise making resources available” to either QDs or Non-QDs
- See slide 38 below for more details



Global calculation

- Calculate at the global charity level, not specific asset level – *i.e.*, not restricted to spending 3.5% or 5% of the specific assets constituting the DQ asset base and all charitable disbursements can be used to meet the DQ
- Sometimes referred to “global calculation”

#### 5. Track DQ Shortfall and Excess



##### DQ Excess

- Occurs when a charity spends more on charitable activities or qualifying disbursements than its DQ for that year
- Excess can be carried forward for 5 years or carried back 1 year

##### DQ Shortfall

- Occurs when a charity spends less on charitable activities or qualifying disbursements than its DQ for that year
- Shortfall can be met using excess from past 5 years or from next year
- Continuous shortfalls may lead to revocation of a charity’s registration

## E. What are the Challenges Posed by Changes in the DQ?

### 1. Charitable versus Management & Administration Activities

- The CRA has not yet provided guidance about how charities should calculate which expenditures are used in administration & management of the charity
- Unanswered questions include:
  - Can amounts be allocated on a percentage basis, similar to fundraising expenses are permitted?
  - e.g. If an employee spends 90% of time engaged in carrying out charitable activities and 10% doing administrative work, is “substantially all” of the work charitable for purposes of the DQ, as is the case with fundraising expenses?
- This is a similar problem to the lack of direction from the CRA concerning how to calculate the pro-rated portion of a building not used directly in charitable activities or administration

### 2. Determining what is an Eligible Qualifying Disbursement to Meet the DQ

- Bill C-19 concerning qualifying disbursements amended the ITA so that “gifts made by [a charity] that are qualifying disbursements” will satisfy the DQ
  - See, e.g., ss. 149.1(2)(b), (3)(b), and (4)(b) of the ITA
  - Since qualifying disbursements are disbursements “by way of a gift or by otherwise making resources available,” then “making resources available” would not be able to satisfy the DQ
- However, if only gifts are counted towards the DQ, this would exclude “making resources available” to qualified donees and non qualified donees, including:



- It is not clear, though, why Schedule 8 to the T3010 about meeting the DQ includes the term “grants” in tracking what meets the DQ obligation when that term is defined by the CRA as being broader than “gifts” to QDs and Non-QDs

### 3. Challenges for Charities with Endowments to Meet 5% DQ

- For charities, and in particular, foundations with endowments or other funds that have restrictions concerning how or when capital can be expended, it may be difficult to meet a 5% DQ with only income generated from the investment available for disbursement, particularly when “income” does not reflect a “total return” investment definition of income
- Charities may find that they need to apply to court for an order granting permission to encroach on the capital or realized capital gains of an endowment
  - Unfortunately, court applications can be costly and time consuming and success is not guaranteed
- Difficulty meeting the DQ may also prompt charities to possibly pursue riskier investments to obtain a higher rate of return, which might be contrary to their fiduciary obligations under applicable provincial *Trustee Act* legislation

### 4. Compliance with non-arm’s length and anti-avoidance rules

- Charities must comply with anti-avoidance rules when gifts to qualified donees are made between non-arm’s length charities:

#### Non-Arm’s Length Transfer Rule

- A charity that receives a gift from a non-arm’s length charity must use 100% of the gift on its:
  - Own charitable activities or
  - “Gifts” that are qualifying disbursements to qualified donees or grantee organizations with which it deals at arm’s length in the fiscal period the gift was received or in the following fiscal period
- See paragraph 149.1(4.1)(d) of the ITA
- Failure to do so could result in a 110% tax on the unexpended amount or the revocation of the receiving charity’s registered status

#### Designated Gift

- Alternatively, the donor charity may make a designated gift (a gift that is not counted in meeting the donor charity’s own DQ obligation)
- The recipient charity then does not have to spend 100% of the designated gift by the end of the next fiscal period

- Even where charities are arm's length, charities must also comply with a broader anti-avoidance rule:

#### Anti-Avoidance Rule

- A charity that enters into a transaction (which may include an inter-charity gift) 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” could face a 110% penalty or possibly revocation
  - See paragraph 149.1(4.1)(a) of the ITA
  - Note that this provision was not modified by Bill C-19 or Bill C-32 but the concept of a “transaction” may now include qualifying disbursements
- If an inter-charity transfer is involved, both charities are jointly and severally, or solitarily liable for the 110% penalty and risk revocation

### 5. Correctly Reporting the Disbursement Quota in the T3010

- Budget 2022 indicated that the CRA will “improve” the collection of information to better identify whether charities are meeting the DQ, as well as “information related to investments and donor-advised funds held by charities”,
- CRA released version 24 of Form T3010, *Registered Charity Information Return* (“Form T3010”) on January 8, 2024, which includes a new schedule 8 to be used for fiscal year ending on or after December 31, 2023
- Charities need to ensure that they properly and fully complete the DQ portion of the T3010 and that they meet their annual DQ obligation
- Failure to properly complete the T3010 can result in the suspension of tax receipting privileges by the CRA until the required information is provided

- **Line 5900 in T3010** - average value of property not used directly in charitable activities or administration during the 24 months before the beginning of the fiscal period - This is used to calculate the DQ obligation for the current fiscal period
  - For example – if T3010 is for fiscal Jan. 1 to Dec. 31, 2024, then line 5900 is for period Jan. 1, 2022 to Dec. 31, 2023
- **Line 5910 in T3010** – average value of property not used directly in charitable activities or administration during the 24 months before the end of the fiscal period - This is used to calculate the DQ obligation for the next fiscal
  - For example – if T3010 is for fiscal Jan. 1 to Dec. 31, 2024, then line 5910 is for period Jan. 1, 2023 to Dec. 31, 2024

2022 fiscal

2023 fiscal

T3010 for 2024 fiscal

**Line 5900 in T3010 for 2024** – FMV for this 24 month period - To calculate DQ for 2024 fiscal

**Line 5910 in T3010 for 2024** – FMV for this 24 month period - To estimate DQ for 2025 fiscal

- New Question C-17 and Schedule 8 to track DQ
- **Question C-17 (and line 5850)** – asks if the charity has average value of property not used directly in its charitable activities or administration exceeding \$100,000 if the charity is a charitable organization, or exceeding \$25,000 if the charity is a public or private foundation
- If so, then their DQ rate is not nil (see table above), and it has to complete Schedule 8
- **Schedule 8** has 2 Steps
  - Step 1 calculates the DQ obligation for the fiscal year the charity is reporting, and whether the DQ has been met
  - Step 2 calculates the estimated DQ obligation for the next fiscal year in order that the charity can plan ahead
  - However, line 850 and line 5045 includes total amount of “grants” made to Non-QDs in the current year without explaining that only “gifts” to QDs and Non-QDs count towards meeting the DQ and not qualifying disbursements that consist of “otherwise making resources available”

## F. Key Takeaways



DQ rules are complicated and overlap with rules under the Qualifying Disbursement Regime



Important for charities to carefully track the DQ obligation during the current taxation year



Challenges for charities with endowments to meet 5% DQ, which might necessitate a court application



Challenges in determining what is an eligible qualifying disbursement to meet the DQ Obligation



Need to carefully complete the DQ portion of the T3010 – prudent to seek legal review, as well as obtain board approval

## G. Resource Materials on Disbursement Quota Regime

- Terrance S. Carter, Jacqueline M. Demczur & Theresa L. M. Man, “Complexities of the Disbursement Quota Calculation: More Than Just a Number” *Charity & NFP Law Bulletin No. 498*, 25 August 2021 <https://www.carters.ca/pub/bulletin/charity/2021/chylb498.pdf>
- Terrance S. Carter & Theresa L.M. Man, “Reminder for Charities to take the Necessary Steps to Meet the DQ” *Charity & NFP Law Bulletin No. 507*, 24 February 2022 [https://www.carters.ca/index.php?page\\_id=456](https://www.carters.ca/index.php?page_id=456)
- Terrance S. Carter, “Disbursement Quota Reform: Stabilizing a Three-Legged Stool” *Perspectives on Tax Law & Policy*, vol 3, no 1, March 2022 [https://www.carters.ca/index.php?page\\_id=475](https://www.carters.ca/index.php?page_id=475)
- Terrance S. Carter, Theresa L.M. Man & Jacqueline M. Demczur, “Draft Budget Implementation Legislation Will Increase DQ and Affect Trust Reporting” *Charity & NFP Law Bulletin No. 515*, 24 August 2022 [https://www.carters.ca/index.php?page\\_id=520](https://www.carters.ca/index.php?page_id=520)
- Terrance S. Carter, Theresa L.M. Man & Jacqueline M. Demczur, “Bill C-32 Will Increase DQ, Affect Trust Reporting, and Make Other Changes to the Income Tax Act” *Charity & NFP Law Bulletin No. 517*, 23 November 2022 [https://www.carters.ca/index.php?page\\_id=554](https://www.carters.ca/index.php?page_id=554)



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