CBA Charity Law Conference April 25, 2025

The Disbursement Quota: *The Regime and Working Within It*

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Agenda

Topic	Speaker
What is the Disbursement Quota?	Theresa
Timeline and Changes	Theresa
Determining DQ	Gwenyth ("**Gwen**")
Meeting Current Obligations	Gwen
Reporting DQ in T3010	Theresa
Reducing Obligations	Theresa
Accumulation/Administration & Management Expenses	Gwen
Anti-Avoidance Rules and Challenges	Gwen
"Is it DQable?" & Q+A	Theresa & Gwen

2

What is the Disbursement Quota?

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What is the Disbursement Quota?

- Also known as the "**DQ**"
- Minimum annual amount charities must spend on charitable activities or qualifying disbursements
- Ensures charitable funds are used for charitable purposes
- Required under *Income Tax Act* ("**ITA**")
- 0-5% of average value of property owned by a charity in the preceding 24 months, amount depends on the value of the property
- DQ applies to all charities but is of particular relevance to 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)

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Timeline and Changes

Timeline of Disbursement Quota

1976
DQ first introduced

1984
Significant reform, 4.5% DQ applies to public and private foundations

2004
DQ reform – DQ became more complex, rate reduced to 3.5% but extended to charitable organizations

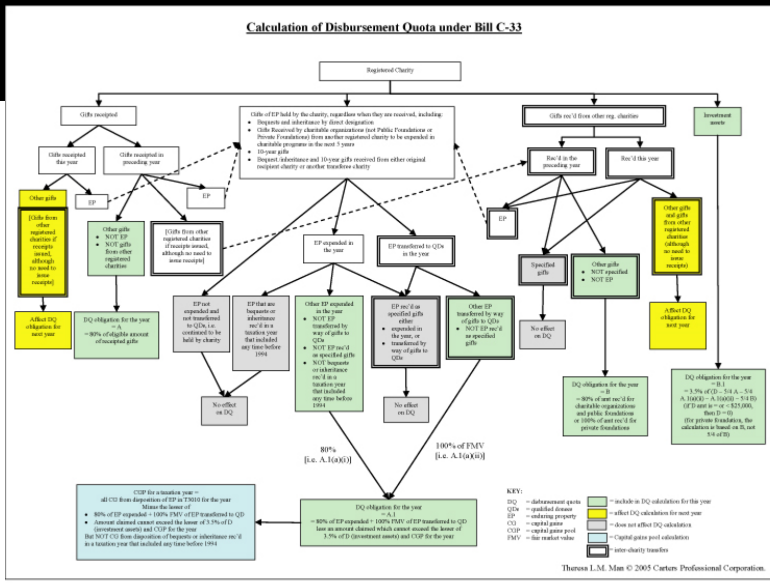
2010
Major DQ Reform exempts ≤$100,000 (charitable organizations) or ≤$25,000 (foundations) from DQ

2021
Department of Finance holds consultation on increasing DQ

2022
Gifts that are qualifying disbursements must be part of DQ; budget and draft legislation proposes increasing DQ to 5% for amounts over $1M

2022 (Dec. 15)
Bill C-32 *Fall Economic Statement Implementation Act, 2022* receives royal assent; 5% increase over $1M becomes law

DQ as of 2005



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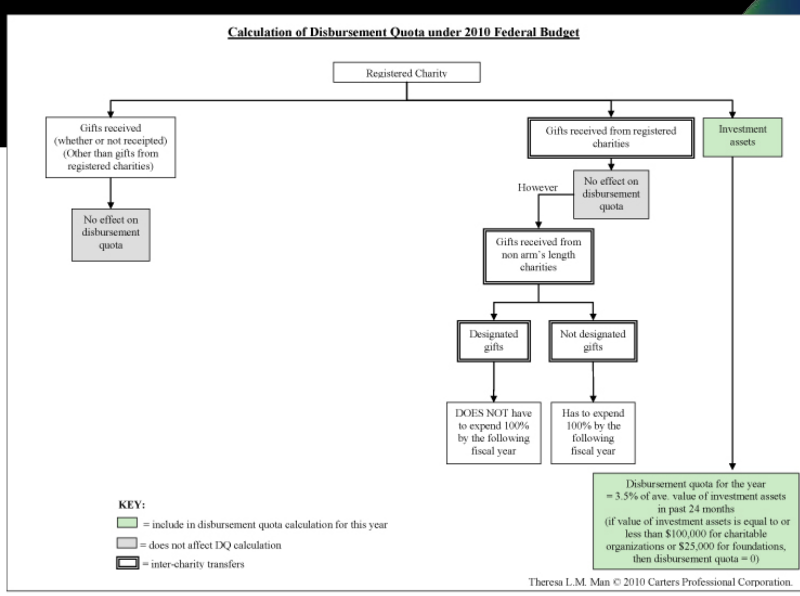
2010 DQ reform



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Determining DQ

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Current DQ Formula (as of Jan. 1, 2023)

- Following consultations in 2021, 2022 Federal Budget announced DQ would be 5% for amounts over $1 million
- *Fall Economic Statement Implementation Act, 2022* (Bill C-32) received Royal Assent December 15, 2022
- ITA amended to increase DQ from 3.5% to 5% for charities holding property over $1 million that is not directly used in charitable activities or administration
- Applies to tax years beginning on/after Jan. 1, 2023

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10

DQ Rate

Charitable Foundation	Charitable Organization	DQ Obligation	
At or below $25,000 of property	At or below $100,000 of property	None	
Over $25,000 - $1,000,000 of property	Over $100,000 - $1,000,000 of property	3.5% of property	
Over $1,000,000 of property	Over $1,000,000 of property	Before Jan. 1, 2023 3.5% of property	Starting Jan. 1, 2023 5% of property
Note: Property refers to the average value of property owned by the charity in the preceding 24 months			

Meeting Current Obligations

Calculating DQ Obligations

1. Property included: Any not directly used in charitable activities or administration (e.g., any cash, investments, land, buildings, stocks, GICs, etc.)
   - Prior to Dec. 31, 2022, charities could apply for permission to accumulate funds for larger projects
2. Time frame: based on preceding 24 months immediately preceding the taxation year
3. Calculate average value over time: determine average value of property over 2 (i.e., annually), 4 (i.e., semi-annually), or 8 (i.e., quarterly) periods during the 24 months

Meeting DQ Obligations

Expenditures
Only funds spent on charitable purposes and qualified disbursements to qualified donees (or grants to non-qualified donees) count towards DQ

Uncertainty
The new rules say qualifying disbursements are "by way of gift or making resources available."
Making resources available may not actually satisfy DQ

Global Calculation
Calculate for all of the charity's property, not the value of each asset.
A charity must disburse 3.5-5% of DQ asset base, not 3.5-5% of each asset in the asset base

Tracking DQ Excess and Shortfall

Excess

Occurs when a charity spends more on charitable activities/ qualifying disbursements than its DQ for the year

Can be carried forward for 5 years or carried back 1 year

Shortfall

Occurs when a charity spends less on charitable activities/ qualifying disbursements than its DQ for the year

Can be met using excess from past 5 years or next year

Continuous shortfalls may lead to revocation of a charity's registration

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15

Reporting DQ in T3010

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Reporting DQ in T3010

- Charities need to ensure that they properly and fully complete the DQ portion of the T3010 and that they meet their annual DQ obligation
- 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 – to be used for fiscal year ending on or after December 31, 2023 or later
- T3010 version 24 contains a new schedule 8 on tracking and reporting DQ calculations

Tracking DQ in T3010

All charities that completes Schedule 6 of the T3010 must do basic calculation of the asset base that forms the calculation of the DQ

Property not used in charitable activities:

Enter the average value of property not used for charitable activities or administration during:

• The 24 months before the **beginning** of the fiscal period	5900	$
• The 24 months before the **end** of the fiscal period	5910	$

- **Line 5900** - average value of property not used directly in charitable activities or administration during the 24 months before the <u>beginning</u> of the fiscal period - This is used to calculate the DQ obligation for the <u>current</u> fiscal
- **Line 5910** – average value of property not used directly in charitable activities or administration during the 24 months before the <u>end</u> of the fiscal period - This is used to calculate the DQ obligation for the <u>next</u> fiscal

Tracking DQ in T3010

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

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Tracking DQ in T3010

New Question 17 in Section C, and Schedule 8 to track DQ

- **Question 17 (and Line 5850)** – asks whether charity has average value of property not used directly in its charitable activities or administration over $100,000 (charitable organization), or exceeding $25,000 (foundation).
- If so, its DQ rate is not nil, and it has to complete Schedule 8

C17 In the 24 months before the beginning of the fiscal period, did the average value of your charity's property (cash, investments, capital property or other assets) not used directly in its charitable activities or administration:
(a) exceed $100,000, if the charity is designated as a charitable organization; or
(b) exceed $25,000, if the charity is designated as a public or private foundation? .... 5850 ☐ Yes ☐ No
If **yes**, you **must** complete Schedule 8 – Disbursement quota

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20

Tracking DQ in T3010

Schedule 8 has 2 Steps

- Step 1 calculates the DQ obligation for the fiscal year the charity is reporting, and whether the DQ is met, or if there is excess or shortfall
- Step 2 calculates the estimated DQ obligation for the next fiscal year in order that the charity can plan ahead

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Disbursement quota — **Schedule 8**

Important: If you complete this section, you **must** answer **yes** to question **C17**.

For more information, go to Canada.ca/charities-disbursement-quota.

Step 1. Calculating the disbursement quota requirement for the current fiscal period

Average value of property not used in charitable activities or administration (line 5900 from your return)	805	$
If permission to accumulate property has been granted, enter the total amount accumulated less all disbursements made for the specified purpose (add all amounts from lines 5500 minus all amounts at lines 5510 from **all returns** to date covered by the permission to accumulate property period)	810	$
Line 805 minus line 810 (if negative, enter 0)	815	$

If line 815 is $1,000,000 or less

Multiply line 815 by 3.5%	820	$

If line 815 is over $1,000,000

Line 815 minus $1,000,000	825	$
Line 825 multiplied by 5%	830	$
Line 830 plus $35,000	835	$

Enter the amount from line 820 or line 835. This is your charity's disbursement qu ta requirement for the current fiscal period	840	$
Total expenditures on charitable activities (line 5000 of your return)	845	$
Total amount of grants made to non-qualified donees (line 5045 of your return)	850	$
Total amount of gifts made to qualified donees (line 5050 of your return)	855	$
Add lines 845 to line 855	860	$
Line 860 minus line 840. This is your charity's disbursement quota excess or short fall for the current fiscal period	865	$

If a shortfall exists (line 865 is negative), your charity can draw on disbursement excesses from the five previous fiscal periods to help it meet its shortfall. If no excesses are available to draw on, your charity can try to spend enough the following year to create an excess that it can carry back to cover the shortfall.

Step 2. Estimating the disbursement quota requirement for the next fiscal period

Average value of property not used in charitable activities or administration prior to the next fiscal period (line 5910 from your return)	870	$

If line 870 is $1,000,000 or less

Multiply line 870 by 3.5%	875	$

If line 870 is over $1,000,000

Line 870 minus $1,000,000	880	$
Line 880 multiplied by 5%	885	$
Line 885 plus $35,000	890	$

The amount shown at line 875 or line 890 is your charity's estimated disbursement quota requirement for the next fiscal period.

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Tracking DQ in T3010

- **Line 5750** - amount for which the charity has received CRA's written approval to reduce its DQ for the fiscal period
  - Use Form T2094 - *Registered Charities: Application to Reduce Disbursement Quota* to apply for a DQ reduction
  - If CRA grants DQ reduction, the charity must amend the T3010 return for the fiscal period in which the shortfall occurred to include the approved amount on line 5750 – Use Form T1240, *Registered Charity Adjustment Request*

Permission to reduce disbursement quota:

If the charity has received approval to make a reduction to its disbursement quota, enter the amount for the fiscal period .... 5750 $ ____________

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23

Reducing Obligations

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Obligation Reduction

- CRA has discretion to reduce a charity's DQ obligation for a particular year if it failed to meet its requirement (and incurred a shortfall) due to circumstances beyond its control – as an alleviating provision to allow a charity to correct a deficiency in meeting its DQ
- A reduction is only granted in extraordinary circumstances where the charity has exhausted all other means to make up the shortfall
- Can only receive approval for a reduction after the CRA issues a Registered Charity Information Return Summary for the fiscal period after the shortfall
- CRA deems a charity's DQ obligation to be reduced upon application by the charity (Subsection 149.1(5) of ITA)
  - Previously, CRAs 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

Obligation Reduction

- CRA can release information to the public on a charity's application to reduce its DQ obligation (ITA s. 241(3.2))
- Reduction applications are submitted using Form T2094
- If a reduction is granted, the charity must amend its T3010 for the shortfall year using Form T1240

Accumulation/Administration & Management Expenses

Accumulation of Property (A Discontinued Practice)

- Prior to Bill C-32, charities could apply to exclude accumulated property from their DQ calculation
- This allowed charities to set aside funds for specific projects without increasing their disbursement obligation during a certain period
- An application that was granted before Jan. 1, 2023 is still valid until the specified period expires

Administration & Management Expenses

- Bill C-32 added para. 149.1(1.1)(d) to the ITA, clarifying that administrative and management expenses **do not** satisfy the DQ requirements
- Draft legislation released on August 12, 2024 to further amend para. 149.1(1.1)(d) to exclude fundraising from DQ calculation
- What counts as an administrative and management expense? No guidance from CRA
- What happens to mix use expenses?
  - For example, if an employee spends 90% of their time on charitable work and 10% of their time on administrative work, can 90% of their wage go towards the DQ?

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29

Anti-Avoidance Rules and Challenges

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Rule #1 – Gifts between non-arm's length charities

Anti-Avoidance Rule

- When a charity gets a gift from a non-arm's length charity, it must disburse the entire gift in the fiscal period it was received, or in the following fiscal period on charitable activities or qualifying disbursements
- Failing to do so could result in a 110% penalty on the amount or a revocation of charitable status

Designated Gift

- To avoid the 100% expenditure requirement, the donor charity must make the gift a "designated gift", so it does not count towards that charity's DQ
- The recipient does not have to spend 100% of the designated gift in the next fiscal period

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31

Rule #1 – Gifts between non-arm's length charities

Designated Gift

- If the recipient charity does not use the designated gift in its charitable activities or administration, it becomes part of its DQ asset base
- The donor charity marks the gift as a designated gift by answering "yes" to **line 2000** on its T3010 and not accounting for the designated gift in **line 5050** when reporting total gifts to qualified donees (does not help donor meet its DQ obligation)
- On the blank line below the amount of non-cash gifts, write in "designated gift"

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32

Rule #2 – Gifts between arm's length charities

Broad Anti-Avoidance Rule

- Even if a transaction is between arm's length charities, it must not "reasonably be considered that a purpose of the transaction was to avoid or unduly delay the expenditure of amounts on charitable activities"
- Charities failing to meet this obligation can face a 100% penalty or revocation (ITA s. 149.1(4.1)(a))
- The definition of "transaction" may include qualifying disbursements
- If an offending transaction was between charities, both charities are jointly, severally, or solitarily liable for the penalty and both risk revocation

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33

Challenges to Meeting DQ

Restrictions	Uncertainty	Need for Risk
Charities (particularly foundations) with endowments or other funds that have restrictions on capital expenditures may find it difficult to meet the DQ Endowments and restricted funds often limit expenditures to only income generated from the investment	Getting permission to encroach on capital or realize capital gains from an endowment requires an application to the court Court proceedings are expensive, time-consuming, and there is no guarantee of success	If charities struggle to meet their DQ, it prompts them to pursue high risk, high reward investments to get a higher rate of return This can be contrary to a charity's fiduciary obligations under the *Trustee Act*

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34

Resources

Historical changes

- M. Elena Hoffstein and Theresa Man, "New Disbursement Quota Rules Under Bill C-33", Canadian Bar Association /Ontario Bar Association 3rd National Symposium On Charity Law, May 6, 2005
  https://www.carters.ca/pub/article/charity/2005/tlm%200506.pdf
- Theresa Man, "Disbursement Quota Reform: The Ins And Outs Of What You Need To Know", 2011 NATIONAL CHARITY LAW Symposium, May 6, 2011 at https://www.carters.ca/pub/article/charity/2011/tlm0506.pdf

Recent changes since 2021

- 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

Resources

- 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
- 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
- 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
- Terrance S. Carter and Urshita Grover, "Draft Legislation Released to Amend the Income Tax Act" CHARITY & NFP Law Update, August 2024 https://www.carters.ca/pub/update/charity/24/aug24.pdf

Is it DQable?
Q+A

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Theresa L.M. Man, B.Sc., M.Mus., LL.B., LL.M. – A partner with Carters, Ms. Man practices in the area of charity and not-for-profit law, is ranked by *Lexpert*, *Best Lawyers in Canada*, and *Chambers and Partners*, and received the 2022 OBA AMS/John Hodgson Award of Excellence in Charity and Not-For-Profit Law. She is a co-author of *Corporate and Practice Manual for Charitable and Not-for-Profit Corporations* published by Thomson Reuters. She is a former member of the Technical Issues Working Group of the CRA Charities Directorate, a member and former chair of the CBA Charities and Not-for-Profit Law Section and the OBA Charities and Not-for-Profit Law Section. Ms. Man has also written on charity and taxation issues for various publications.

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Gwenyth Stadig, JD, MA, BSc – Gwenyth has extensive experience advising non-for-profits and registered charities including colleges, universities, religious organizations, agricultural and heritage organizations, humane societies, and complex trade organizations on matters related to tax, trust, and corporate compliance. Gwenyth is a member of multiple Ontario Bar Association and Canadian Bar Association Committees. She is the past chair of the OBA Charity & Not-for-Profit Law group. She is a member of the Bar of Ontario and Bar of Newfoundland and Labrador

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39

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40