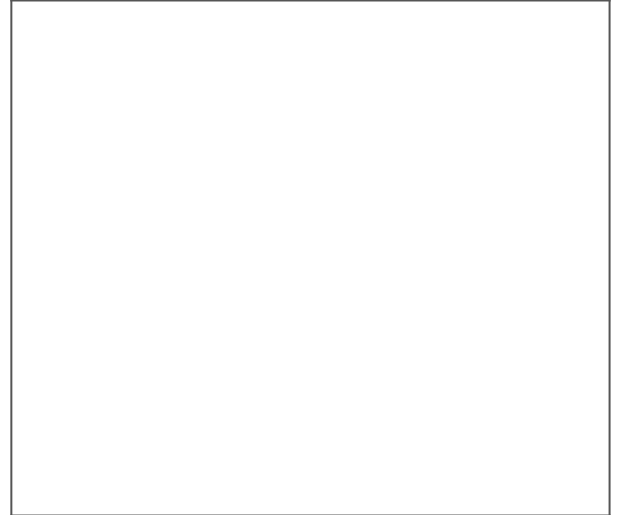


Disbursement Quota Reform

published 04/01/2010

Charities and advocates for charities have long been calling for the elimination of the disbursement quota as “an unduly complex and costly administrative burden on charities”. The federal government’s Budget 2010 has responded with proposals to reform the disbursement quota.

Details of the changes can be found on the government’s website, specifically at www.budget.gc.ca/2010/plan/anx5-eng.html#a15. **[link no longer active]** For convenience, I have reproduced the details, set out below.



CHARITIES: DISBURSEMENT QUOTA REFORM

Background

It is estimated that Canadian individuals will receive \$2.4 billion in federal tax relief on charitable donations of \$8.8 billion in 2009. In addition, corporations benefit from a deduction with respect to charitable donations.

Charitable activities are not defined in the Income Tax Act; instead, the meaning of charitable purposes and charitable activities in Canada is largely determined by jurisprudence. Charities must devote their resources to charitable purposes. The Income Tax Act specifies requirements for registration as a charity as well as grounds for revocation of that status. The Canada Revenue Agency determines the eligibility of an organization to be a registered charity for federal income tax purposes, based on an examination of the organization’s purposes and activities. In addition, charities are subject to corporate and trust law.

The disbursement quota was introduced in 1976 to help curtail fundraising costs and limit capital accumulation. The disbursement quota is intended to ensure that a significant portion of a registered charity’s resources are devoted to charitable purposes.

In general terms, the disbursement quota requires that the amount a charity spends each year on charitable activities (including gifts to qualified donees) be at least the sum of:

- 80 per cent of the previous year’s tax-receipted donations plus other amounts relating to enduring

- property and transfers between charities (in other words, a “charitable expenditure rule”); and
- 3.5 per cent of all assets not currently used in charitable programs or administration, if these assets exceed \$25,000 (in other words, a “capital accumulation rule”).

Some have observed that the impact of the charitable expenditure rule can vary considerably, for reasons unrelated to the manner in which a charity conducts its charitable activities. For example, some charities have a wide range of revenue sources from which to fund their charitable activities, such as grants received from governments and revenues from related business activities. Since all charitable expenditures count toward meeting the disbursement quota, these charities have little difficulty satisfying it even if they do not spend their tax-receipted donations on charitable activities. In contrast, the rule is much more constraining on many small and rural charities that rely mainly on tax-receipted donations.

Stakeholders such as Imagine Canada have called for the elimination of the disbursement quota because it imposes “an unduly complex and costly administrative burden on charities – particularly small and rural charities” and it constrains the flexibility of charities, without achieving its core purpose of limiting spending on fundraising and non-charitable activities.

Recent legislative and administrative initiatives have strengthened the Canada Revenue Agency’s ability to ensure that a charity’s fundraising and other practices are appropriate. For example, the Canada Revenue Agency publication “Fundraising by Registered Charities” provides guidance for charities on acceptable fundraising practices.

The Canada Revenue Agency may impose sanctions or revoke the registration of a charity in situations where charities use their funds inappropriately, such as in cases where there is undue private benefit. These tools provide a more effective and direct means to fulfil the objectives of the charitable expenditure rule of the disbursement quota.

Budget 2010 proposes to reform the disbursement quota for fiscal years that end on or after March 4, 2010. Specifically, Budget 2010 proposes to:

- repeal the charitable expenditure rule;
- modify the capital accumulation rule; and
- strengthen related anti-avoidance rules for charities.

The Government will monitor the effectiveness of the Canada Revenue Agency’s guidance on “Fundraising by Registered Charities”, and take action if needed to ensure its stated objectives are achieved.

Repeal of Charitable Expenditure Rule

Budget 2010 proposes to repeal the charitable expenditure rule. Consequently, provisions relating to a number of concepts will no longer be required to calculate the disbursement

quota:

- enduring property (gifts to a charity for endowments or multi-year charitable projects which are not subject to the charitable expenditure rule);
- the capital gains reduction and the capital gains pool (provisions that ensure that capital gains realized from the disposition of enduring property are not subject to the charitable expenditure rule and the capital accumulation rule);
- specified gifts (a provision that allows charities with disbursement excesses to help charities with disbursement shortfalls to meet their disbursement quota requirements); and
- exclusions from the calculation of the base to which the 3.5-per-cent disbursement rate is applied (provisions that ensure that funds subject to the charitable expenditure rule are not also subject to the capital accumulation rule).

Budget 2010 also proposes to amend the existing rule that provides the Canada Revenue Agency with the discretion to allow charities to accumulate property for a particular purpose, such as a building project. The existing provision states that property accumulated after approval from the Canada Revenue Agency and any income earned in respect of that property is deemed to have been spent on charitable activities. This rule will require amendment in the absence of the charitable expenditure rule. In order to allow a charity to accumulate property for a particular project, the Canada Revenue Agency will be given the discretion to exclude the accumulated property from the capital accumulation rule calculation.

Modify the capital accumulation component

There is currently an exemption from the capital accumulation rule for charities having \$25,000 or less in assets not used in charitable programs or administration. Budget 2010 proposes to increase this threshold to \$100,000 for charitable organizations. This increase will reduce the compliance burden on small charitable organizations and provide them with greater ability to maintain reserves to deal with contingencies. The threshold for charitable foundations will remain at \$25,000.

The amount of all assets not currently used in charitable programs or administration, for the purpose of the capital accumulation rule in the disbursement quota, is subject to a calculation provided for in the Income Tax Regulations. This calculation requires a technical amendment to clarify that it applies both to charitable foundations and charitable organizations.

Strengthen anti-avoidance rules

Budget 2010 proposes to extend existing anti-avoidance rules to situations where it can reasonably be considered that a purpose of a transaction was to delay unduly or avoid the application of the disbursement quota.

Budget 2010 proposes provisions to ensure that amounts transferred between non-arm's length charities will be used to satisfy the disbursement quota of only one charity. It is proposed that a recipient charity, in such circumstances, be required to spend the full amount transferred on its own charitable activities, or to transfer the amount to a qualified donee with which it deals at arm's length, in the current or subsequent taxation year. Alternatively, the transferring charity will be able to elect that the amount transferred will not count towards satisfying its disbursement quota, in which case the recipient charity would not be subject to the immediate disbursement requirement under the anti-avoidance rules."

DISCLAIMER: *This article is presented for informational purposes only. The content does not constitute legal advice or solicitation and does not create a solicitor-client relationship. The views expressed are solely the authors' and should not be attributed to any other party, including Thompson Dorfman Sweatman LLP (TDS), its affiliate companies or its clients. The authors make no guarantees regarding the accuracy or adequacy of the information contained herein or linked to via this article. The authors are not able to provide free legal advice. If you are seeking advice on specific matters, please contact Keith LaBossiere, CEO & Managing Partner at kdl@tdslaw.com, or 204.934.2587. Please be aware that any unsolicited information sent to the author(s) cannot be considered to be solicitor-client privileged.*

While care is taken to ensure the accuracy for the purposes stated, before relying upon these articles, you should seek and be guided by legal advice based on your specific circumstances. We would be pleased to provide you with our assistance on any of the issues raised in these articles.