Scotia Private Client Group

Philanthropic Advisory Services

2010 Federal Budget Comment

Charity Disbursement Quota Reform

March 12, 2010

Charities will have more flexibility and less administrative burden in carrying out their charitable purpose after the Federal Budget of March 4, 2010. The Budget repealed the disbursement quota regime, which has been part of the Income Tax Act since 1976. The changes apply to all registered charities beginning in the fiscal year ending on or after March 4, 2010.

Key Points:

1. The 80/20 rule for ordinary receipted donations is eliminated. Charities will no longer be required to use 80% of receipted donations for charitable purposes by the end of the year following receipt.
2. Enduring property has been eliminated. Gone with it is the "10-year" gift provision, which excluded lifetime donations from the 80/20 formula if the capital was held for a minimum of 10 years. While charities can still hold investments and other property long-term, there are fewer obligations stemming from the Income Tax Act.
3. The "capital gains pool" has been repealed. This was a mechanism that obligated charities to track realized capital gains in a separate account.
4. The specified gifts, which are a rare form of inter-charity transfer, are gone. They have been replaced by "designated" gifts, which are gifts with designations stipulated by the transferring charity.
5. Charities must spend on charitable purposes an amount equal to at least 3.5% of eligible property owned in 24-month period prior to the current year. This is unchanged from the previous rules, but "charitable organizations" with less than $100,000 in property will be exempt from the requirement. As previously was the case, the rule only applies to foundations with at least $25,000 in property.
6. The complex inter-charity transfer rules associated with enduring property and ordinary grants have been dropped. Penalties have been introduced to prevent related charities from delaying the use of charitable funds. These penalties include increased disbursement obligations and a sanction equal to 110% of the amount involve for both charities.

History

The disbursement quota system was introduced into the Income Tax Act in 1976. Its core components were the 80/20 rule and the 10-year rule. Initially, only foundations had an obligation to spend income generated by capital. The rules were rewritten in 2005 to introduce concepts such as enduring property and the capital gains pool. While some of these rules were helpful, the revisions have been a source of widespread confusion and expensive compliance for charities.

The system was too complex for most volunteer-based charities and inhibited the effective use of charitable property in certain circumstances. For example, in the recent financial crisis some charities were unable to use capital of 10-year gifts due to market declines – despite urgent community need. Extensive discussions between the charitable sector and the Federal Government have resulted in these reforms.

Implications

The March 4th rules have refashioned the regulatory regime for charities. The following comments represent our initial thoughts about the implications for charities.

1. The new rules are simpler. There is less information to track, fewer funds needed, and there will be simpler reporting to Canada Revenue Agency (CRA). Ideally, this will lower administrative costs for charities and enable greater compliance with the remaining rules. Since 66% of Canada's 85,000 charities have annual revenue of less than $100,000 per annum and are volunteer run, greater simplicity is helpful.
2. Charities now have greater discretion about how and when charitable funds are deployed. Budgeting and planning will be more flexible. This is especially valuable for charities that rely on annual receipted donations and revenue from investment funds.
3. Foundations that depend on endowments will see very little difference in the disbursement quota requirement. The 3.5% requirement is still in effect, but the administrative requirements will be lighter and the ability to exceed minimum disbursement quota requirements greater due to access to capital.
4. Charities can now have "spend-down" funds. For example, a donor may make a gift for a project and pay out all the funds over eight years. Previously using a mixture of capital and income was more difficult as the only two options for lifetime donations were the 10-year hold or spending 80% within a year. While spend-down funds are used by certain charities, like our own Aqueduct Foundation, the concept should now become more widespread.
5. Total return investing is now permissible for charities. Total return investing does not distinguish between capital and income. Now interest, dividends, capital gain and even capital can be distributed to meet the annual 3.5% payout. While total return investing has been widespread for years, it was not consistent with the old disbursement quota rules.
6. Further to point 5, the Income Tax Act provisions for charities are no longer based in trust law concepts of capital and income. While donors and charities

may apply trust condition to gifts – for example, creating a perpetual endowment – there are no restriction on the use of capital in the tax system. The conflict of laws that occurred in the past should be eliminated in the future.

7. Pledge forms, endowment fund agreements, brochures, and investment policies will need to be rewritten.

8. While existing 10-year gift restrictions will no longer need to be tracked, it will take some time to determine what to do with gifts and funds documented under the previous regime. Legal counsel will be required in many cases.

9. Charities receiving grants from other charities, such as the United Way or private foundations, do not have to spend 80% by the end of the following year. Neither the recipient nor the granting charity will be bound to incorrect disbursement quota characterization at the time of the gift. With the exception of new category of designated gifts, all grants will be the same for disbursement quota purposes.

10. Charities will be reporting different information to CRA in the future and a new T3010 form will be released by CRA, although the timing is unclear. CRA has indicated that charities with year ends after March 4th should use the existing T3010B, even though it tracks information that is no longer required.

11. The regulatory role of Canada Revenue Agency (CRA) will most likely change. Expect to see a greater emphasis by CRA on monitoring charities to ensure that charitable resources are used properly. CRA, too, will have less administrative burden, which means they will redeploy resources to other forms of oversight and support. Documents like CRA's Fundraising Guidance (CPS-028) will take on a new importance.

12. The rules put a new emphasis on mission and fiduciary responsibilities and less on technical requirements and obscure formulas. This may initially be disorienting for charity administrators, but a significant record keeping, legal and accounting burden has been lifted. The risk of greater freedom is potential abuse. The challenge for charities is to use these new rules responsibility and create maximum public benefit.

For more information, please contact:

Malcolm D. Burrows
Head, Philanthropic Advisory Services
Scotia Private Client Group
Tel: 416-933-2351
malcolm.burrows@scotiaprivateclient.com