

A week or so after the issue hit the front pages, we had the most dramatic protest. Munir Sheikh,² the head of Statistics Canada, resigned over the decision to scrap the mandatory long-form census.

"I want to take this opportunity to comment on a technical statistical issue which has become the subject of media discussion. This relates to the question of whether a voluntary survey can become a substitute for a mandatory census," Sheikh said in a release.

"It cannot," he said. "Under the circumstances, I have tendered my resignation to the prime minister."

In fairness, there have been cases where in the face of reasoned arguments, the Harper government has backed down from ill-conceived ideas. Remember changing the words of "O Canada"? Perhaps this will be another case where some sober second thought will restore the status quo.

2 Many readers will remember Sheikh from his long service at Finance before going to Statistics Canada.

FOUNDATIONS AND DISBURSEMENT QUOTA REFORM

Daniel Frajman

The federal budget of March 2010 contained proposals for significant reform of the disbursement quota applicable to registered charities.¹ The Canada Revenue Agency indicates that although implementing legislation has yet to be introduced, it has begun to apply the new rules,² and the Province of Quebec has indicated that it will harmonize its tax legislation to incorporate these changes.³ This article will briefly highlight the changes, and then focus on some of their implications, which appear to be positive, for charitable foundations.

The disbursement quota rules as they existed prior to the budget were intended to serve two purposes: to ensure the timely expenditure of receipted donations on charitable activities, and to limit administrative costs and fundraising expenses of charities. However, the rules were too complicated to apply in practice, and no other jurisdiction employs a similar approach to regulate charitable expenditures.⁴ Change to the disbursement quota was required, and the CRA seemed to telegraph last year (in charity policy statement CPS-028, hereinafter the "Fundraising Policy Statement") that its enforcement would focus instead on issues such as more realistic limits on fundraising expenses.⁵

The budget therefore, in a nutshell, does the following (for fiscal years that end on or after March 4, 2010):

- (a) The 80 percent disbursement quota (the "80 percent DQ"), which basically has required charities to spend each year on charitable activities at least 80 percent of the previous year's tax receipted donations, is repealed;
- (b) the 3.5 percent disbursement quota (the "3.5 percent DQ"), which basically has required charities to spend each year at least 3.5 percent of their assets not being used directly in charitable activities and administration⁶ (often, investment assets stemming from endowments) is retained, although the first \$100,000 of such assets will now be exempt from the 3.5 percent DQ when the charity is a charitable organization (basically, a working charity involved more so in charitable activities other than donating to other charities). For foundations (which basically fund other charities), the exemption in this regard will remain at the existing level of \$25,000;
- (c) new anti-avoidance rules are introduced to prevent charities from unduly delaying expenditures on charitable activities, and to deal with certain aspects of non-arm's length inter-charity transfers;
- (d) several definitions (namely, "capital gains pool", "enduring property" and "specified gift") that have been relevant in relation to the now repealed 80 percent DQ, have therefore lost their relevance, and are also repealed. Therefore, so-called "10-year gifts"

1 Federal Budget of March 4, 2010, at www.budget.gc.ca.

2 Charities: Disbursement Quota Reform (at www.cra-arc.gc.ca/gncy/bdgt/2010/chrt-eng.html).

3 Quebec Budget of March 30, 2010 (Additional Information on the Budgetary Measures, at www.budget.finances.gouv.qc.ca/Budget/2010-2011).

4 Parachin, Adam, "Disbursement quotas undergo much-needed overhaul" *The Lawyers Weekly* (April 9, 2010) 9.

5 See the Fundraising Policy Statement, titled "Fundraising by Registered Charities" (June 11, 2009), which states that a charity with a ratio of costs to revenue over a fiscal period of under 35 percent, is unlikely to generate questions or concerns with the CRA.

6 Basically, 3.5 percent of the average value of the charity's assets in the 24 months immediately preceding the taxation year that were not used directly in charitable activities and administration.

(i.e., gifts subject to a trust or direction that the capital of the gift be held by the charity for at least 10 years), which have been part of the enduring property definition, are also repealed.

It has been observed that increased assistance for small and rural public charities has been a priority for the CRA over the last few years, and that the elimination of the 80 percent DQ will be of particular help to them, and it has been further observed that no longer will charities have to struggle with structuring long-term gifts or endowment funds to comply with complex *Income Tax Act* language relating to 10-year gifts and other enduring property.⁷

Although the budget changes therefore appear positive for charities, the budget states that charities may not use their funds inappropriately, and the CRA's Website contains a warning that notwithstanding the new rules, charities may not spend their money however they want, and that further guidance in this regard will follow in the future. On its Website, the CRA writes:

Registered charities have always had to devote their resources to charitable programs to maintain their charitable registration, and this is still the case. The disbursement quota requirement is just one part of the rule. Recent legislative and administrative initiatives have strengthened the CRA's ability to ensure that charities are spending their money on charitable programs, and have helped charities understand which expenditures are appropriate. For example, the CRA recently published the [Fundraising Policy Statement], which provides guidance to charities on what are acceptable fundraising expenditures....In addition, the CRA will develop further guidance to assist registered charities in understanding and complying with the reformed disbursement quota and other income tax rules concerning expenditures. This development will include consultation with the charitable sector.⁸

Indeed several observers have essentially noted that although the new rules seem to have the advantage of simplicity, the departure of the 80 percent DQ means that a bright line "safe harbour" for charities will have disappeared, and that a gap has been created in the regulation of charities that will lead to the CRA taking steps to attack charities

that do not meet the CRA's expenditure expectations. This may lead to future legislation, perhaps reminiscent in spirit or form to the 80 percent DQ, that re-regulates charities.⁹

As far as foundations are concerned with respect to the new rules, the following appear at this time to be the most important implications (at least for foundations that do not fundraise and therefore will not be preoccupied with the CRA's apparent focus on the Fundraising Policy Statement):

- (a) new funds contributed to the charity will no longer have to be stipulated as being a 10-year gift (or have to otherwise be set up as enduring property by way of, for example, a bequest). It should be possible to use the capital of such new funds to remedy disbursement quota shortfalls;
- (b) disbursement quota shortfalls can be remedied by contributing new funds to the charity for which the donor can receive a donation receipt¹⁰ (the repeal of the 80 percent DQ removes the possible disincentive to receipt gifts);
- (c) regarding old 10-year gifts, and subject to applicable rules under provincial contract, trust and other private law, it will often be possible for the donor and the foundation to agree in writing that the capital of the gift can henceforth be encroached upon, even if 10 years have not passed from the time of the gift.¹¹ It should then be possible to use the capital of that old gift (including to remedy disbursement quota shortfalls).

Another preoccupation of many foundations, which is worth addressing in light of the new budget rules, is the situation where an operating

⁷ Cooper, Karen J. and Carter, Terrance S., "Significant Benefit for Charities in 2010 Federal Budget DQ Reform", *Carters.ca Charity Law Bulletin* No. 197 (March 8, 2010, revised April 29, 2010), at pp. 1 and 4.

⁸ See Charities: Disbursement Quota Reform, *supra* at note 2, at questions 12 and 13.

⁹ Aptowitz, Adam, "Ghost of Disbursement Quotas Past" *Canadian Not-For-Profit News* (April 2010) 25 and *The Canadian Taxpayer* (March 23, 2010) 44; Bourgeois, Donald, "Eliminating the Disbursement Quota: Gold or Fool's Gold?" 23-2 *The Philanthropist* (2010) 184; and Drache, Arthur, "Charities Mulling Disbursement Quota Changes" *Canadian Not-For-Profit News* (May 2010) 33.

¹⁰ However, the CRA has stated recently that a registered charity should not issue official donation receipts for gifts it receives from other registered charities. See Drache, Arthur, "Charity to Charity Gifts" *Canadian Not-For-Profit News* (May 2010) 39.

¹¹ See Drache, *supra* at note 9, at page 35, where it is recommended that charities "determine how much of [their] asset base is impressed with a trust (whether a '10-year' trust or a more substantive one) and determine to what extent the funds can be accessed and what procedures must be followed. This could range from an agreement with the original donor to an application to the provincial public trustee." In Quebec in any event, for gifts subject to a direction that the capital be held by the charity for at least 10 years, and containing no other material conditions, the original donor and the charity likely have the right to themselves waive the 10-year stipulation.

charity transfers real estate (e.g., immovable property in Quebec) to a foundation, perhaps as part of a plan to "creditor proof" the operating charity.¹² This kind of transfer has in the past been recognized by the CRA (which, for example, at CPS-026 of May 1, 2008, has stated that "the simple act of holding title to property on behalf of another registered charity is sufficient for registration purposes").¹³

As will be noted below, it does appear that the budget, including its new anti-avoidance rules, will not preclude such transfers of real estate. Unlike earlier changes to the disbursement quota rules, where it seems that measures to provide relief to charities sometimes had an opposite effect,¹⁴ the budget seems sufficiently clear in this regard.

One of the budget's anti-avoidance rules provides for penalties where it can reasonably be considered that a purpose of a transaction was to delay unduly or avoid the application of the disbursement quota. A transfer of real estate as referred to above should not be off-side of this rule, as the transfer would seem to actually increase the potential disbursement quota exposure of the property. (To the extent that the property falls into the 3.5 percent DQ, the abovementioned new \$100,000 exemption from the disbursement quota would not apply to a property transferred from a charitable organization to a public foundation.)

The other anti-avoidance rule in the budget is meant to ensure that amounts transferred between non-arm's length charities will be used to satisfy the disbursement quota of only one charity. The

rule requires the transferee to immediately use in the ensuing year the property transferred, but this rule is inapplicable so long as the transferring charity elects on its information return to treat the gift as a "designated gift" (somewhat akin to the old specified gift) that will not count towards satisfying the transferor's disbursement quota.

Also notable is that the budget's new definition of disbursement quota keeps the exemption (with respect to the remaining 3.5 percent DQ) for property "used directly in charitable activities or administration", with the apparent result that so long as, for example, a reasonable rent on the real estate is charged by the transferee public foundation to the transferor charitable organization, the real estate would be seen as being used by the transferee in charitable programs or to help administer the tenant charity, and would be shielded from the 3.5 percent DQ in the hands of the transferee.¹⁵

The recent disbursement quota reform therefore appears positive for charities, insofar as the 80 percent DQ has been repealed, and capital encroachment is made easier with regard to the 3.5 percent DQ. Cautionary commentary as to how aspects of the reform will be interpreted by the tax department appear to be less applicable to foundations, although certainly those involved in fundraising should focus on the implications of the CRA's 2009 policy statement on fundraising (CPS-028).

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12 This situation is referred to in Drache, Arthur, "Land Transfer Tax Amendment in Manitoba and Ontario" *Canadian Not-For-Profit News* (May 2010) 40.

13 The transferee of the real estate in this situation will often be a public foundation (which has an arm's length board, and an ability carry on direct charitable activities).

14 For example, changes introduced in the 2004 federal budget likely reduced the ability to encroach on 10-year gifts in order to satisfy disbursement quota shortfalls. Prior to that change, many charities took the view (the CRA did not necessarily approve) that if there were any gains on 10-year capital, the gains could be used to help meet disbursement quotas if the original donated capital was preserved. (See Drache, Arthur, *Canadian Taxation of Charities & Donations* (2003) at p. 3-22.) The 2004 budget limited the ability to use gains in this way, by introducing a "capital gains pool" equal to realized capital gains, which could be accessed to meet shortfalls in the 3.5 percent DQ to the extent that the 10-year gift contained a stipulation allowing for such encroachment. The current budget thankfully does away with these apparent impediments to accessing capital, including the capital gains pool.

15 This result seems to be implied by CPS-026 of May 1, 2008, and the result does not appear to be overridden by the budget.

B.C. DEFICIT LOWER THAN PREDICTED

In the past couple of years it has become difficult to assess where provincial finances are going because of ongoing updates of figures. Depending on which base figures you decide to use, the changes can be interpreted any way you want.

Consider the British Columbia situation.