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Adapting to Evolving Disbursement Quota Regulations

November 9, 2023



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Introducing



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ADAPTING TO EVOLVING DISBURSEMENT QUOTA REGULATIONS

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Agenda

1. Refresher on Disbursement Quota calculation
2. Amendments to the ITA
 - Increase in DQ rate
 - Administration and management expenditures
 - Relief from DQ
3. Additional reporting requirements
4. Sample DQ Calculation
5. Questions?



Disbursement Quota Calculation: A Refresher

- Disbursement Quota (DQ): the minimum amount a registered charity is required to spend each year on its own charitable activities or on qualifying disbursements
- Calculated as a percentage of the average value of a charity's property, exceeding a certain threshold, that was **not** used directly in charitable activities or administration during the 24 months before the beginning of the fiscal year
 - Threshold = \$25,000 for private foundations; \$100,000 for other charities



Disbursement Quota Calculation:

(Cont'd)

- How do you determine the “average value” of the applicable property?
 - The 24 month period is divided into 2 to 8 equal periods (the number of periods is selected at discretion of the charity on its first T3010)
 - The value of the property the charity holds during each period is calculated and the total is divided by the number of periods to determine the “average value”



Disbursement Quota Calculation:

(Cont'd)

- How do you know what property is not used in charitable activities?
 - Property includes any real estate, investments or other assets that are not used in charitable activities or administration
 - But what if the category the property falls into is not clear?
 - Example: If you own a building that you use to carry out your charitable programs, for example a church building where regular services are held, you would not include this in the disbursement quota calculation. But if a portion of the building is being used for non-charitable activities, then that portion should be prorated and included in the calculation



Changes to the Income Tax Act

- Budget tabled April 7, 2022 proposed changes to the DQ
- Bill C-32, the Fall Economic Statement Implementation Act, 2022, received Royal Assent on December 15, 2022
- Changes to the DQ apply to fiscal periods starting on or after January 1, 2023.



Increased DQ Rate

- Amendments introduced a new graduated DQ rate
- DQ will increase from 3.5% to 5% on the portion of property not used in charitable activities and administration that exceeds \$1 million
- The amendments do not change the way the DQ is calculated (based on the average value of applicable property)



Clarification on Administration and Management Expenditures

- To satisfy the DQ, charities must spend on charitable activities and qualifying disbursements
 - There are lines on the T3010 for expenditures on charitable programs and gifts to qualified donees
 - There will be new lines added for grants to non-qualified donees
- There is a new provision stating that expenditures on administration and management are excluded from the calculation of expenditures that satisfy the DQ
 - CRA suggests this has always been its position



Budget Amendment to the ITA

- Budget documents stated as follows:
 - *New paragraph (d) provides that expenditures on administration and management of the charity shall not be considered "charitable activities carried on by the organization itself" for the purposes of satisfying the disbursement quota. This provision excludes expenditures for management, administration and fundraising from satisfying the disbursement quota requirements. Whether a particular expenditure relates to management, administration and fundraising will be a factual determination based on the activities and practices of the organization. This amendment applies to taxation years beginning on or after January 1, 2023.*



Current Approach to Administration and Management Expenditures

CRA EXAMPLES OF EXPENDITURES ON ADMIN & MANAGEMENT:

- Board of Directors meetings
- Accounting, auditing, HR salaries
- Supplies and equipment
- Applying for grants
- Occupancy costs for buildings used for admin services

CRA EXAMPLES OF EXPENDITURES ON CHARITABLE ACTIVITIES:

- Running day-to-day programs
- Education and training for staff and volunteers
- Most salaries
- Occupancy costs for buildings used for charitable activities

- Clearly there is overlap
- CRA has acknowledged that some expenditures can be partly charitable and partly management and admin
- More guidance and consultation to come



Current Approach to Administration and Management Expenditures (Cont'd)

- What does the current T3010 and T4033 – Guide to completing the return say?
 - **As per section D4 of T4033 guide:**
 - “Some expenditures can be considered partly charitable and partly management and administration, such as salaries and occupancy costs. In these cases, divide the amounts accordingly between lines 5000 and 5010. Expenditures must be allocated consistently and on a reasonable basis.”



Current Approach to Administration and Management Expenditures (Cont'd)

- What does the CPA Canada Handbook say?
 - **As per section 4470 of CPA handbook:**
 - "Attribution and allocation of expenses
 - 4470.05 Occasionally, fundraising expenses include amounts which are specifically directed at another function (for example, education). In determining whether any expenses included in the fundraising function might be allocated to another function, there must be a reasonable basis for making such an allocation, applied on a consistent basis. (...)
 - 4470.07 General support expenses are either considered a function in their own right or are allocated on a reasonable and consistent basis to the relevant functions that they support."



Current Approach to Administration and Management Expenditures (Cont'd)

- What has CRA said elsewhere?
 - **As per CRA Ruling document 2006-0168601E5:**
 - “(...) Regarding the issue of allocation, in cases where costs are partly attributable to charitable programs and partly to management and administration, the T4033A guide states that it will be necessary to allocate the expenditures between these two categories and the allocation should be made on a consistent and reasonable basis.”



T3010 Expenditures

Expenditures:

Advertising and promotion	4800	\$	
Travel and vehicle expenses.....	4810	\$	
Interest and bank charges.....	4820	\$	
Licences, memberships, and dues	4830	\$	
Office supplies and expenses.....	4840	\$	
Occupancy costs	4850	\$	
Professional and consulting fees	4860	\$	
Education and training for staff and volunteers	4870	\$	
Total expenditure on all compensation (enter the amount reported at line 390 in Schedule 3, if applicable)	4880	\$	
Fair market value of all donated goods used in charitable activities	4890	\$	
Purchased supplies and assets	4891	\$	
Amortization of capitalized assets.....	4900	\$	
Research grants and scholarships as part of charitable activities	4910	\$	
All other expenditures not included in the amounts above (excluding qualifying disbursements)	4920	\$	
Specify type(s) of expenditures included in the amount reported at 4920.....	4930		
Total expenditures before qualifying disbursements (add lines 4800 to 4920)	4950	\$	
Of the amounts at lines 4950:			
(a) Total expenditures on charitable activities.....	5000	\$	
(b) Total expenditures on management and administration	5010	\$	
(c) Total expenditures on fundraising	5020	\$	
(d) Total other expenditures included in line 4950.....	5040	\$	
Total grants made to non-qualified donees (grantees).....	5045	\$	
Total amount of gifts made to all qualified donees	5050	\$	
Total expenditures (add lines 4950, 5045 and 5050)	5100	\$	



Relief from Disbursement Quota

- New provision allowing charities to apply to CRA to request a reduction in DQ
 - CRA has discretion and may publicly disclose decisions.
- The accumulation of property rule has been removed
 - Allowed charities to apply to CRA for permission to accumulate property (and not include the property in the DQ calculation)
 - Rule not necessary in light of new DQ relief provision



Relief from Disbursement Quota

(Cont'd)

- Relief from DQ should be viewed as an option of last resort
- CRA expects that all DQ excesses have been used
 - Disbursement excesses can be carried forward 5 years or carried back 1 year
- Charities may need to revisit their investment strategies



Changes to Form T3010

- Budget 2022 indicated that CRA intends to improve the collection of information from charities
- CRA will make changes to T3010 and the guide to completing it (Form T4033)
 - Will likely include additional questions on donor advised funds and endowments
- There have been no legislative changes to permit DQ requirements to apply on a fund-to-fund basis



What does this mean for your CF?

- What does your disbursement policy say?
 - If it restricts the amount that can be disbursed from funds to 3.5%, it will need to be amended
- What does your template gift agreement say?
- Do existing gift agreements need to be amended?
 - If your existing gift agreements specify a 3.5% disbursement, this could be a problem if you are not spending in excess of this amount overall
 - If existing gift agreements need to be amended, how can this be done?



Final Thoughts

- The new DQ rate applies to fiscal years going forward
- More details will come on how to distinguish between “DQ-able” expenditures on charitable activities versus management and administration expenses
- What does CRA intend to do with additional information it collects on DAFs and investment assets?



Questions?

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