Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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# The disbursement quota – What is it, and what are the recent changes?

In the weeks following the 2022 Federal Budget being announced by Canadian Finance Minister, the Honorable Chrystia Freeland, there was a buzz in the news regarding the increase of the disbursement quota (DQ) from 3.5% to 5%. This may be a new term to you, or it may be one you've heard before but not given much attention to.

If you run a Canadian charity (including a public or private foundation), the changes announced on April 7, 2022, may impact your charity significantly.

## What is it?

The DQ is the **minimum** amount that a registered charity must spend on its own charitable activities or on grants to other registered charities on an annual basis. The intention behind the DQ is to ensure that registered charities do not indefinitely hold the property they have been fortunate enough to grow or acquire from taxpayers with tax assistance (donation receipts and a tax-free environment). The DQ guarantees that every year, a minimum of the property is used or distributed for **charitable purposes**, while still allowing for most of the property to remain invested and grow, thus ensuring the charity can continue to pursue their future charitable endeavours.

Once a year, the DQ is calculated based on the value of the registered charity's property not used in its charitable activities or administration. Property includes any real estate (e.g. land, buildings), investments and other assets. For example, consider a charity that provides housing to those in need. It may own the building its residents live in, but also have commercial rental space in this building. The value of the real estate attributable to the residential use (the charitable purpose of the organization) would be excluded from the DQ, whereas the commercial space would be included in the DQ.[1]

## Calculating the DQ

The DQ is calculated on a 24-month average. It's calculated slightly differently for foundations and operating charities. If an operating charity has property not used in charitable activities or administration valued over $100,000 or if a foundation's property is more than $25,000, then it must spend or grant 3.5% of the average value of property in the 24 months preceding the start of the last fiscal year.[2] It's important to note that there are other items that may impact the DQ for tax purposes that may not be reflected in this article. With this in mind, it's essential to seek advice from a qualified tax advisor when determining the charity's DQ.

For example:

A private foundation currently has a portfolio of investments of $1.5 million, with a fiscal year-end of December 31. Due to market fluctuations, donations into the foundation, and grants out of the foundation, its value fluctuated over the 24 months prior to December 31 of 2021. On December 31, 2020, it was $1.5 million and dipped to $900,000 on December 31, 2021. The average value over the 24-month period would be $1.2 million. The private foundation would have to grant out $42,000 in this fiscal year to meet the 3.5% DQ.

## Changes with the 2022 Canadian Federal Budget

The 2022 Federal Budget made changes to the DQ calculation for fiscal years effective January 1, 2023. Firstly, there were a few changes to what is included in the calculation. The new measures will not consider the payment of administration and management expenses as qualified expenditures when calculating the DQ. In addition, the CRA will no longer be able to grant exemptions from the DQ for specific properties owned by a registered charity. Finally, the CRA's ability to grant relief from the DQ will be curtailed, and any grants of relief will be reportable on the CRA's publicly searchable registered charities database, which in itself may be a deterrent for potential donors.

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The second change is that the DQ will now be calculated on a graduated basis. If a registered charity has property worth less than $1 million, the DQ calculation of 3.5% will continue to apply. The biggest change to the DQ is for registered charities with property greater than $1 million. In this case, the DQ will remain the same for the first $1 million in property. Any property over the $1 million will be subject to a higher 5% DQ. Let's use the above example:

Again, the average value over the preceding 24 months is $1.2 million.

| | |
|---|---|
| First $1 million (3.5% DQ) | $35,000 |
| Next $200,000 (5% DQ) | $10,000 |
| **Total to be distributed in 2023** | **$45,000** |
| Difference from prior year calculation ($42,000 - $45,000) | -$3,000 |

## Why the DQ has changed

It might feel like this change is a significant jump for the DQ but, prior to 2004, the DQ was considerably higher. The calculation was reduced to a flat 3.5% of property in 2004 to allow registered charities to build capital to allow them to be more resilient in times of financial fluctuations. The goal of the charitable tax system is to encourage donations to charities and foundations (through tax credits) so that the donated funds can be used to positively impact the community. This measure was successful (in part), and through an improved economy, increased donations and market conditions, assets owned by registered charities have been increasing.

To give an example of the landscape today, 6,200 of the over 86,000 registered charities in Canada are private foundations.  In 2010, private foundations held just over $19.44 billion in assets and granted more than $1.2 billion to qualified donees (or approximately 6.5%). In 2018, these private foundations had grown to more than $56.3 billion and granted out just $2.6 billion (or approximately 4.5%). The 2018 assets owned by private foundations is a 290% increase in value over 2010.[3] At a time when the demands on the services of operating charities has never

1 There are some exceptions to the DQ. For example, it's currently possible for a registered charity to apply to the Canada Revenue Agency (CRA) for permission to accumulate specific property that would not be subject to the DQ calculation. In addition, there are relieving provisions where the CRA is able to grant a year's DQ relief for a registered charity — they would not have to grant anything in the year where this is obtained.

2 Under certain circumstances, if a foundation is not able to meet its DQ from its investment returns or donated funds in a given year, it can use DQ excesses accumulated from its prior five-year rolling average of disbursements. For example, if they disbursed 8% three years ago, and were only able to disburse 3% this year, they could use some of the excess 4.5% from three years ago.

3 Canadian Foundation Facts - Philanthropic Foundations Canada (pfc.ca)

been higher, many advocates for the charitable sector of philanthropy have been exploring how to ensure more of these assets intended for charitable purposes end up in the hands of operating charities to support their efforts.

## What the DQ increase means to my registered charity

As outlined, the increased DQ may not be that overwhelming given the operating charity, or the foundation's property and history of granting. Many private foundations already grant out more than 5% of their assets on an annual basis, so the change will have no impact on their granting activity.

If you're concerned about how to manage your increased DQ, here are a few ideas to consider:

- An increase in the DQ doesn't have to mean increasing the number of grantees. If you've already done the due diligence and trust an organization, consider simply increasing the size of your grants.
- Another option is to offer targeted capacity-building/catalyzing grants to your existing grantees. You could ask them to identify an operational/internal need they have that, if solved, would help truly catalyze their work and fund it. You already trust these organizations to use the granted funds appropriately; this additional granting may enable them to evolve their work, shifting from A-B-C-D and instead being able to go from A to D and onto E.
- If you're not already doing this, you could use a portion of this additional DQ to impact areas that other family members are passionate about. For example, the private foundation could fund grants to organizations where your children or grandchildren volunteer their time.
- Another option is to take the excess grant capacity and focus it on the under-resourced parts of the charitable sector. If there are many needs that are not being met in your community, ask your current grantees what they are seeing fall through the cracks. For example:
  - In 2021, just 3.3% of online donations made in Canada supported Indigenous Peoples.
  - According to one research report focused on Black communities within Canadian philanthropy, among public and private foundations reviewed, Black-serving and Black-led organizations received only 0.13% and 0.03% of total grants, respectively, during the two fiscal years examined.[4]

4 *Unfunded: Black Communities Overlooked by Canadian Philanthropy.* The Network for the Advancement of Black Communities and Carleton University's Philanthropy and Nonprofit Leadership program. Research period: 2017 to 2018. Published: 2020. https://www.forblackcommunities.org/#report

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