APPENDIX

ISSUES ASSOCIATED WITH CURRENT DISBURSEMENT QUOTA REGIME

Description of the disbursement quota

All registered charities are subject to an **income spending obligation** commonly known as the ***80/20 rule***. Under this rule, registered charities are required to disburse a percentage (usually 80%, but 100% in the case of some types of income for private foundations) of specified types of income received in their previous fiscal year. Subject to some exceptions, this measure generally applies to receipted income and to inter-charity transfers. For example, most non-receipted income, such as government funding or earned revenue, is not captured under the 80/20 provisions. As well, some income is not subject to the 80/20 rule until it is spent. Ten year gifts (donations that the donor legally specifies cannot be spent for ten years or more) are the best known category of income not immediately subject to the 80/20 rule.

Registered charities are also subject to a **capital spending obligation** referred as the **anti-accumulation or *3.5% rule***. Under this rule, they are required to disburse an amount equal to 3.5% of the average value of their investment property annually. Ten year gifts, or property substituted for them, are subject to this 3.5% disbursement requirement until they are spent.

Issues associated with the disbursement quota

There are numerous longstanding and profound challenges posed by the current DQ approach with respect to income (80/20 rule) and capital (3.5% rule):

1. **Expenditure requirements are arbitrary** and not linked, in any practical way, to the fulfilment of charitable purpose.

2. **The legislation does not clearly indicate which expenditures qualify as charitable spending.** Where administration or fundraising costs are incurred jointly with charitable program costs, there is uncertainty regarding the charitable and non-charitable categorization of expenses. The current regime does not address this ambiguity, nor can it effectively do so.

3. **The current approach does not take into account the diversity of Canada's charitable sector and places an undue burden on small, rural and remote charities.** The 20% component does not take into account the many differences in geographic circumstance, size, resources, and sophistication of Canada's charities. In particular, it ignores the difficulty small, rural and remote organizations have in achieving administrative economies of scale available to larger organizations, and consequently places unrealistic demands on these organizations. These demands lead to distortions in programs and expenditures to achieve compliance. They also create an unduly complex and costly administrative burden. The disparity in the regime's treatment of receipted and non-receipted donation income also appears to have a greater negative impact on small charities, as there is evidence suggesting these are generally more heavily reliant on receipted income and, therefore, more vulnerable to the distortions and administrative burden of the DQ.

4. **The 3.5% rule, extended to charitable organizations in 2008, is not sensitive to real market returns and unrealistic in an economic downturn**. Rather than calculating this on the rolling average of investment assets, a more reasonable approach would be to adopt a total investment return model or another market-based approach.

5. **Additionally there is now a potential conflict between the newly mandated spending of reserves and the operational (and in some cases statutory) obligations of charitable organizations.** For example, as of 2008, a charity operating a low-income housing project is required to spend 3.5% of its building capital maintenance reserve annually. This is at odds with its obligation (often legal) to set aside revenues annually so that it can make major capital expenditures as its infrastructure wears out.

6. **DQ provisions limit the capacity of charities to deploy funds for maximum impact on their mission.** Charities are required either to spend receipted income within the year following receipt or, depending on the donation obligation, to do so after ten (10) years. This significantly distorts their expenditure options and severely limits their capacity to deploy funds in a timely way to meet short and longer-term needs.

7. **The current approach does not provide useful, reliable information to inform public/donor decisions.** It has become apparent to Imagine Canada that some members of the public and journalists believe that the disbursement quota accredits or certifies the allocation of resources to charitable purposes and is, therefore, a measure of a charity's effectiveness. This erroneous view leads to a misplaced reliance by the public on DQ information.

8. **It also hampers the relationship between donors and charities and distorts the form charitable gifts take,** because it arbitrarily regulates the disbursement of gifts. Often restrictions established by private law provisions in donation agreements are not driven by donor intent but by the need to comply with the ten-year rule.

9. **Restrictions on the use of capital, arising from private law provisions in donation agreements, often make it difficult for charities that want to access this capital to comply with their disbursement quota obligations**.

10. **The enduring property concepts and the capital gains pool are poorly understood** in the sector and, therefore, ineffective measures for offering greater flexibility.

For all of these reasons, Imagine Canada and its members encourage the government to replace the current provisions with a new regime that is both easier to administer and more congruent with the chief policy outcome desired by both the government and the sector – that resources committed to a charitable purpose should be used for that outcome in a timely way.

Imagine Canada
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