

DISBURSEMENT QUOTA REFORM

Restoring the disbursement quota to 5% is a simple and effective tool to grow funding for charities.

Given the mixed response of philanthropic foundations in 2020, we support a higher, temporary disbursement quota for Canada's response and recovery to the covid pandemic.

Charity Intelligence Canada

September 29, 2021

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EXECUTIVE SUMMARY

Finance's decision on the disbursement quota is critically important to build public confidence in the charity sector. The covid pandemic asks much of all Canadians. It has also raised public interest in philanthropic foundations – who they are, what they do, and how much they support charities.

Perhaps for the first time, public attention is on the disbursement quota. Canadians are asking questions about how much multi-million-dollar foundations have contributed. And with it, they are questioning the legitimacy of philanthropic foundations and their contribution to the charity sector.

Finance must respond to these questions, review the status quo, and act in Canada's best interest. Finance also needs to assess other policies like carry-forwards, compliance tools and electronic filing that will strengthen the oversight of philanthropic foundations.

We believe Canada's disbursement quota should be restored to its original rate of 5%. The mixed response of Canada's largest foundations to covid shows that voluntary measures are insufficient. During this past year, 64% of the largest private foundations spent more (and some a lot more) than the current 3.5% disbursement rate. But 22% retrenched and spent less than the 3.5% rate. This varied response justifies a temporary higher disbursement rate.

The health of democracy partially rests on the ability of our institutions to adapt and be responsive to the changing realities in Canada.

Of note: This submission may put us in a precarious position. Our research and analysis of charity data depends upon foundation grants. Some of our funders may not agree with a higher disbursement quota. We know other operating charities are also in a similar position and are not available to publicly speak about the disbursement quota. We hope Finance recognizes this power imbalance in its call for submissions.

Also, we do not agree internally on what the disbursement quota should be. Some of us support a higher rate of 10%, others support 5%. Yet we all believe – our lowest common denominator – that restoring the 5% base is essential, with a higher temporary rate for the covid response.

1. DISBURSEMENT QUOTA

Question 1: Should the disbursement quota be raised to produce additional funding for charities, and to what extent?

In short, yes. Finance should immediately restore Canada's disbursement quota to its original level of 5%.

This would significantly increase funding to charities. It also supports the government's goal of productivity. Foundation assets would produce greater social benefit and impact.

While some foundations give more than the disbursement quota, for far too many, the disbursement quota has become the defacto grant level. Raising the disbursement quota would increase grants to charities and the contribution foundations make to Canada.

To what extent?

That is for Finance to decide. Canada expects Finance's leadership to set the disbursement quota on the available information and in the best interest of all of Canada. Canadians have great trust in the diligence and independence of our public service and your capabilities.

While public consultation is nice, your mandate is to set a public policy that is the best for all of Canada. We trust you will decide on what's right for Canada – on the whole – rather than accommodate an elite of multi-million-dollar foundations and philanthropists for their personal legacies.

The 2021 Budget notes a change in the disbursement quota would result in annual charity spending increasing between \$1 billion and \$2 billion. Given the Budget's range, our sensitivity analysis of 2019 data shows that this additional funding would require a change in the disbursement quota to:

- between 5% and 7% (including Mastercard Foundation)
- between 6% and 8.5% (excluding Mastercard Foundation)

SENSITIVITY ANALYSIS

How a change in disbursement quota produces additional funding	3.5%	5.0%	7.5%	10.0%	12.5%	15.0%
All figures \$ million						
Total additional funding	273	954	2,390	3,990	5,677	7,425
Breakdown:						
Private foundations						
Mastercard Foundation	133	374	776	1,179	1,581	1,983
Largest 100 excluding Mastercard	50	279	734	1,227	1,736	2,254
Private foundations with +\$1m in assets	47	163	428	732	1,057	1,394
All other private foundations	nc	nc	nc	nc	nc	nc
Total for large private foundations	97	442	1,162	1,959	2,793	3,648
Public foundations						
Largest 100	17	51	212	413	646	905
Public foundations with +\$1m in assets	2	19	55	102	154	207
All other public foundations	nc	nc	nc	nc	nc	nc
Total for large public foundations	19	70	267	515	800	1,112
Operating charities *						
Largest 100 charities with endowment assets	14	44	126	230	337	450
Operating charities with endowed assets +\$1m	10	24	59	107	166	232
All other operating charities	nc	nc	nc	nc	nc	nc
Total for large operating charities	24	68	185	337	503	682

* few large universities with endowments reporting

Notes: Using the 2018 ending asset value reported in CRA 2018 data, adjusted where no value found.

Update:						
Addition funding excluding Mastercard Foundation	140	580	1,614	2,811	4,096	5,442
Preliminary indicator of growth in assets	6%					
2022 estimates of additional charity spending	148	615	1,711	2,980	4,342	5,769

"nc" means not calculated

Analysis done by Charity Intelligence, February 2021

Updated September 2021

1. DISBURSEMENT QUOTA

Finance outlines an example of how Australia has different levels of disbursements for private foundations and public foundations.

We don't see this working in Canada. Perhaps Canada doesn't have as strict criteria between private and public foundations and operating charities. We see large operating charities (Type C) and public foundations (Type A) that look very similar to private foundations (Type B).

Also, if public foundations have a lower disbursement rate, this creates an incentive for private foundations to work around a higher quota by transferring assets into donor-advised public foundations.

The same disbursement quota for all types of charities removes any opportunity for avoidance.

2. SUSTAINABILITY OF FOUNDATIONS

Question 2: Would it be desirable to increase the disbursement quota to a level that caused foundations to gradually encroach on investment capital and would it be sustainable in the long-term for the charity sector?

We ask Finance to de-couple its thinking that sets the disbursement quota in consideration of a foundation's long-term sustainability. It was a policy mistake in 2004 to peg the disbursement quota to the bank rate. Policy should be made, not on investment market forecasts, but on actual evidence.

Data clearly shows that the long-term sustainability of foundations is not today's problem. Foundation assets have grown 4.1-fold since 2010. Foundations are bigger than ever before, with bright futures. Finance should monitor this going forward. If there comes a time when foundation assets start to erode, the disbursement quota can be re-examined. There is current capacity for a quota increase.

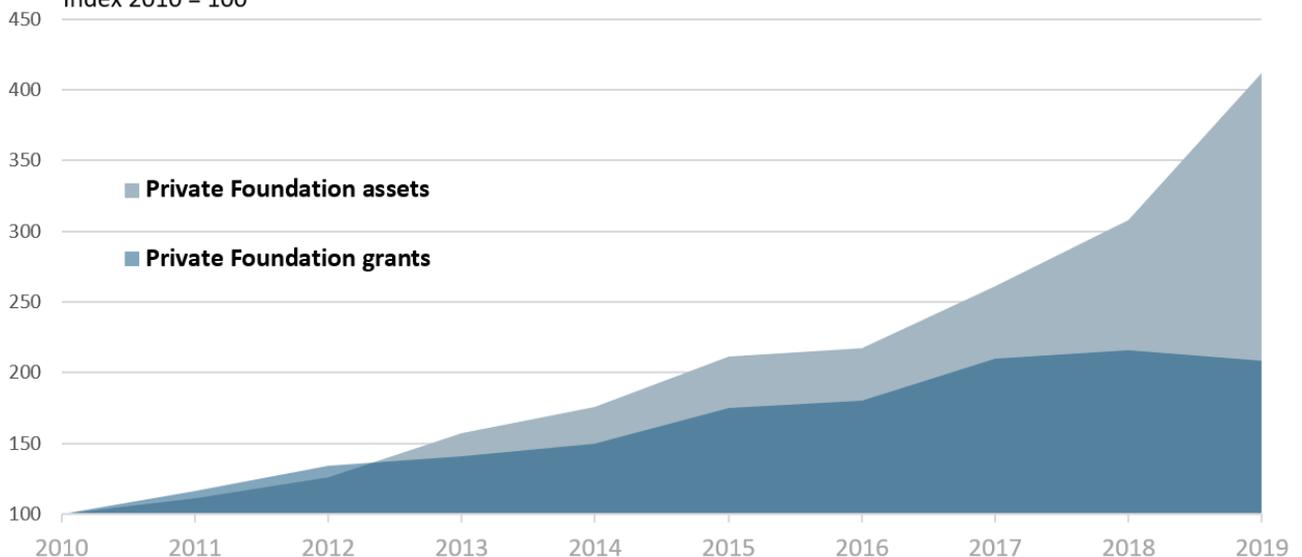
At issue is, with the most generous upfront tax benefits in the world on donations, does the current level of granting best serve Canada's public interest.

While foundation assets have increased, their charity spending has not kept pace. While assets grew 4.1-fold, grants to charities increased 2.1 times.

Budget 2021's data shows this widening gap.

A rebalance needed

Private foundation asset growth relative to private foundation grants
Index 2010 = 100



Source: Federal Budget 2021, [Chart 6.2: Growth in Investment Assets and Qualifying Disbursements](#)

2. SUSTAINABILITY OF FOUNDATIONS

“Are foundations entitled to be sustainable?” is a philosophical question. Should any business or entity, charitable or not, have a government-guaranteed right to exist forever?

To be sustainable forever, generations of a foundation’s directors will need to ensure assets are well managed. Some will, and some won’t.

But surely it is not Finance’s job to preserve an individual foundation by setting a low disbursement quota. In effect, a low disbursement quota subsidizes mediocrity.

While individual foundations may decline and expire, collectively foundations are sustainable. Four of Canada’s five largest foundations today were only established in the last 20 years. Foundations of the 20th century will likely be eclipsed by foundations of the 21st century. This is a healthy “changing of the guard”.

Canada’s future will surely have new philanthropists that will play an even greater role in supporting the charity sector.

3. COMPLIANCE TOOLS

Question 3: What additional tools (e.g., monetary penalties or other intermediate sanctions) should be available to the CRA to enforce the disbursement quota rules?

We believe that Canada Revenue Agency (CRA) already has the tool to enforce the rules.

“If found the purpose was to avoid or unduly delay spending funds on charitable activities, the penalty is 110% of transactions and/or possible revocation.”

The Income Tax Act Anti-Avoidance Rule 149.1 (4.1) & 188.1 (11)/(12)

The disbursement quota is not complex. It is a straight-forward financial calculation:

$$\text{Spending requirement} = DQ \times \text{line 5900}$$

Foundations are obliged to know the rules. Each year, directors should start with knowing exactly how much money the foundation is required to spend. The Income Tax Act requires every charity to keep financial records and ensure it meets its legal requirements. If a foundation fails to spend its requirement, the 110% financial penalty should be automatically assessed on the shortfall.

For example, if a foundation’s disbursement is \$3 million but it only spends \$2 million, the 110% financial penalty should apply on the \$1 million shortfall. The foundation would pay \$1.1 million to the CRA.

The Advisory Committee on the Charitable Sector (ACCS) submits that the CRA generally does not audit charities only for the purpose of discovering non-compliance with the disbursement quota. If true, is it any wonder that so many of the largest foundations appear to have shortfalls in their giving obligations?

Compliance is fundamental to the public’s confidence in the charity sector. We share ACCS’s opinion that the CRA should ensure compliance of the disbursement quota.

3. COMPLIANCE TOOLS

Some may object that a 110% monetary penalty is too harsh. This attitude fails to grasp the enormity of the largest foundations and charities. A 110% penalty on a spending shortfall would be like a parking ticket, yet it would send an effective message.

Non-compliance in disbursements is material

This compliance issue is serious. The shortfall looks like \$81 million in charity spending by just 300 of the largest charities.

- \$50 million shortfall within just the 100 largest private foundations (excluding Mastercard Foundation which is a unique case)
- \$17 million within the 100 largest public foundations
- \$14 million within the largest 100 charities by non-charitable assets

For additional breakdowns on non-compliance, refer to the Sensitivity Analysis under the current 3.5% disbursement quota.

With thousands of foundations, this greater oversight may seem a daunting task. It's not. Using the T3010 data, the Charities Directorate can quickly scan and identify foundations that require additional contact. We recommend sorting this data by the foundations with the largest monetary disbursement deficit.

5. CARRY-FORWARDS

Question 5: Do the existing carry-forward provisions strike the appropriate balance between ensuring the timely disbursement of funds and allowing foundations to make large gifts on a more infrequent basis?

Carry-forwards should only be to Canada's advantage. Carry-forwards should only be for over-disbursements **in the past**. Carry-forwards should not be "on credit". This further unduly delays the public benefit.

An analogy is gift cards compared with credit cards. A gift card is pre-paid and "loaded" for future spending. If a foundation makes a large gift in excess of its disbursement quota, this excess can be carried forward to offset disbursements in future years.

But what must not happen is giving foundations an extension, or extra time, to make large **future** gifts. This is the opposite of paying upfront. This is, in effect, borrowing from the charity sector and Canada's public interest.

6. COVID DISBURSEMENT QUOTA

Question 6: Are there any temporary changes to the disbursement quota that should be considered in the context of the Covid-19 recovery?

From the preliminary but mixed results of how large private foundations responded in the first year of the covid pandemic, a temporary disbursement quota of 7.5%-10% looks appropriate.

On review of the T3010 filings of Canada's largest 100 private foundations, one can see their activity during covid. Of these 100 largest private foundations, the 2020 T3010 filings for 72 of the large private foundations are now posted on the CRA Charity Directorate's website.

Sadly, this analysis shows a varied response to the covid pandemic. Some private foundations were champions. They were first responders for covid, funding frontline charities during the pandemic. This exceptional leadership was not followed by other private foundations. Some foundations that pledged to give +5% reneged on their covid promise.

In the first year of the covid pandemic, here's how 72 of the largest private foundations responded:

64% gave more than the 3.5% disbursement quota, 46 of the 72. Some foundations gave way more, with 10 foundations spending more than 12%. The Rogers Foundation and RBC Foundation disbursed more than 100% of assets.

14% gave exactly 3.5%, 10 of the 72, with charity spending unchanged by the pandemic.

22% spent less than 3.5% during the pandemic, 16 of the 72. This could be unfortunately timed deferred carry-forwards of previous excesses.

Notes on Canada's 100 largest foundations: Charity Intelligence created this category in 2020 based off the 2018 T3010 data. This may not accurately reflect the 100 largest foundations in 2021. For this submission, we wanted to compare how these private foundations responded to covid in relation to data we had for 2018.

Mastercard Foundation is Canada's largest foundation but is excluded from this list because of unique issues. Apotex Foundation is also excluded. In 2020, it granted \$67.8 million, a disbursement rate of 60%, to one charity that is undisclosed.

6. COVID RESPONSE

Covid Champions

Like everything else in the charity sector, there are strong performers and weak performers.

- **The Rogers Foundation** emptied the bank in 2020 and granted \$87 million, a disbursement of 100%. These grants included \$20 million to food banks, \$20 million to homeless shelters, and \$20 million to at-risk youth charities.
- **The Sprott Foundation** more than doubled its disbursements from 17% of assets to 41% of assets during covid. It gave \$17 million to charities serving vulnerable people, including food banks, homeless shelters and Indigenous programs.
- **The Jim Pattison Foundation** is also a standout during Covid Year 1. It increased its disbursement from 8.1% to 18.9%, including \$27 million to hospital foundations.

6. COVID RESPONSE

Key facts on how 72 large private foundations responded to Covid Year 1:

During the covid pandemic, these 72 private foundations spent **\$738 million on charity activities**: \$698 million in grants to charities and \$40 million on in-house charity activities. This is a **27.6% increase** over charity spending in 2018 of \$578 million.

2020's asset values are **\$10.3 billion, an increase of \$604 million, or 6.2% during the year**. Assets at the end of 2020 were 16.7% higher than at the end of 2017. This is due to both new donations to foundations and investment returns.

The average size of these 72 foundations is \$143.6 million in non-charitable assets (investments) at the end of 2020 compared with \$123.1 million in 2017.

In 2020, the average disbursement rate of these 72 foundations was 9.6% compared with an average disbursement rate of 8.1% in 2018. The average disbursement rate is often cited but, because of the wide range in spending, the average rate bears little meaning. Averages are useful when there is a bell curve distribution, that is, when most are around the average. Private foundation spending is all over the map. For example, during the past covid year, one foundation reports spending 0% and one spent 127%.

The analysis of these largest 72 private foundations includes RBC Foundation. This is a private foundation yet acts as a "flow through" with annual grants closely matching annual income. In 2020, RBC Foundation's payout rate is 127%. RBC Foundation's high disbursement rate affects the average disbursement rate by 150 basis points. For example, in 2020, including RBC Foundation creates an average foundation disbursement rate of 9.6%. Without RBC Foundation, the average disbursement rate is 8.1%.

6. COVID RESPONSE

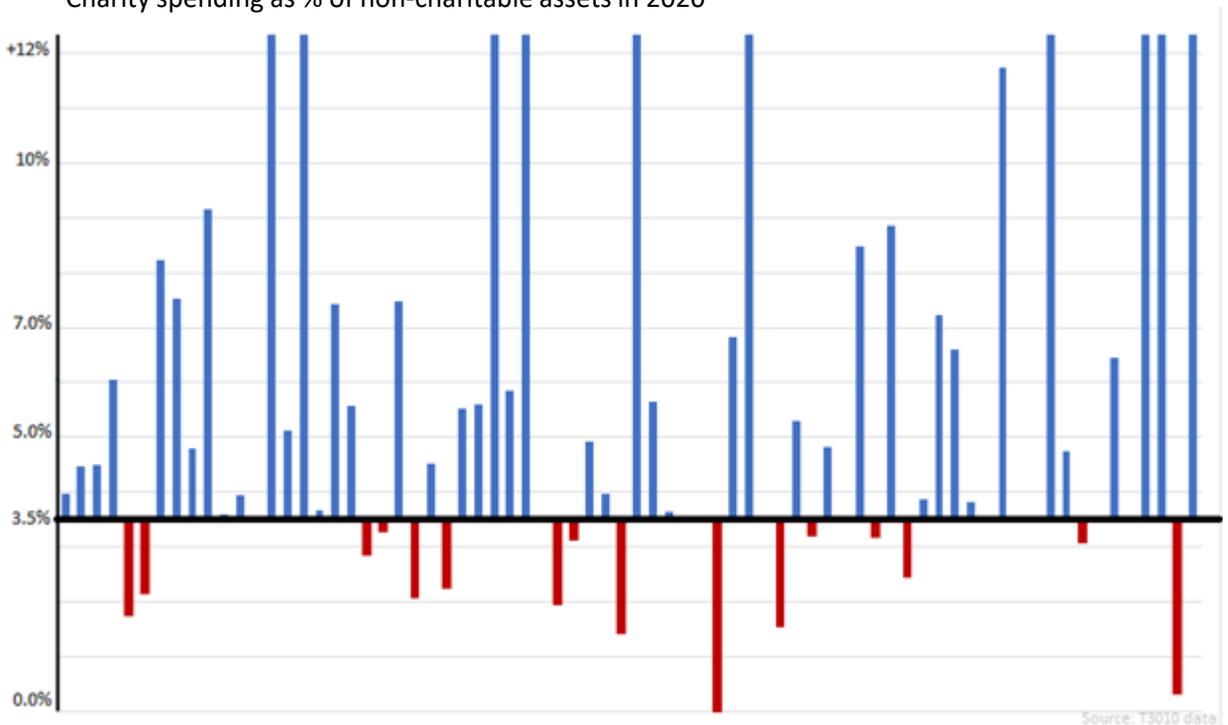
This chart shows the disbursement rates of the 72 largest private foundations for 2020.

Using the 3.5% current disbursement quota as the base line, foundations that spent more than required are in blue. Foundations that spent less than 3.5% are in red. Foundations are shown left to right by non-charitable assets size from highest to lowest.

“Too many of Canada’s largest private and philanthropic foundations are absent in stepping up.”

Charity Intelligence, “Late, but hopefully not too little”
February 2021

Fight or flight: Canada’s largest private foundations had different responses to the covid pandemic. Some spent more, some spent less.
Charity spending as % of non-charitable assets in 2020



6. COVID DISBURSEMENT QUOTA

Based on the analysis of the 72 large private foundations' spending in 2020, here's a rough estimate of how a temporary covid disbursement quota would affect spending. Rather than the additional money, the percentage increase is likely a better indicator of how a covid disbursement rate would affect spending.

One needs to bear in mind this is an influential but small sample size that may not be indicative of all other foundations.

- If a 7.5% disbursement quota was in effect for 2020, charity spending would have increased 36%.
- If a 10% disbursement quota was in effect for 2020, charity spending would have increased 64%.

Disbursement quota covid	7.5%	10%
Increase over actual spending of \$738 million	36%	64%
Additional spending by the 72 largest foundations	\$262 million	\$473 million
Of the 72 private foundations, a higher disbursement quota would have affected how many other of the largest private foundations?	55	61

11 of the largest private foundations spent more than 10% of assets in 2020.

Among these 72 foundations, investment assets increased by \$604 million. Even with a 10% disbursement quota, the size of foundation assets would still increase.

Our model shows a disbursement rate of 11.49% would have offset the increase in foundation assets during 2020.

6. COVID DISBURSEMENT QUOTA

Others have submitted that a higher disbursement quota will not materially increase funding to charities. We disagree. Raising the disbursement quota will be the pivotal reform of Canada's charity sector that will unleash billions in additional annual funding to charities.

Canada's economy in August 2021 is about \$50 billion lower than where it was before covid. "We're not out of the woods" with "shockingly weaker than expected" figures released over the summer. Raising the disbursement quota will not alone get us back to where we were, but it will be a meaningful contribution. Canadian foundations have the capacity to make this greater contribution.

Others have also submitted that a higher disbursement quota may place too much burden on foundations to make this change. For far too long, many of Canada's largest foundations have had it easy by only granting 3.5%.

Moving to a temporary disbursement rate between 7.5%-10% for a short covid period will stretch them. Change is difficult. Yet, thankfully, some foundations made this change quickly.

For those private foundations where the change is too hard, or they lack the capabilities to grant more, the 110% financial penalty is an easy-out option. What would be given to charities can instead be paid to the Charities Directorate for its essential work supporting Canada's charity sector.

"As the Charity Commission's own research shows, the charity sector can no longer count on being given an automatic benefit of the doubt. The public wants reassurance that charities are behaving charitably as well as delivering their charitable purposes...and to meet growing demand depends on retaining the confidence of the public, and the public's view of the value provided by the sector. It is this goodwill that underpins the legal and economic privileges charities enjoy."

UK Charities Commission

IN ADDITION

Get serious.

Sliding scale for transparency and accountability.

Improve data quality for timely tracking.

IN ADDITION

A. Charities should take T3010 filings seriously

There appears to be a cultural attitude in the charity sector of not taking the T3010 return seriously. Canadians take their annual tax returns seriously. Canadians are not given an “education first” approach for failure to pay their taxes. The same rules that apply to you and me should apply to Canada’s largest charities.

From our experience, we feel that “more education” is not the appropriate approach with large charities.

These large foundations – and charities – have the resources and use professionals to manage their investments. Now they need to apply the same dedication to being transparent and accountable by filing complete and correct annual returns.

The clear, legal duty to report already exists. When philanthropists apply to register a charity, the application:

- a. requires complete and accurate information,
- b. the charity’s directors certify the information is “correct, complete and current”,
- c. registration and annual certification clearly states that “it is a serious offence under the Income Tax Act to provide false or deceptive information.” Perhaps Finance could add the words “omissions and incomplete returns”?

IN ADDITION

B. Sliding scale based on a charity's size.

In the UK and Australia, charities are categorized as “small”, “medium” and “large” according to how much revenue they receive each year and how much they own in assets. Each size category has different levels of reporting obligations.

A sliding scale means that higher transparency and accountability requirements are not borne by all charities. The elite of large charities have higher obligations.

If Canada were to adopt a sliding scale it would alleviate the concern of too high a reporting burden on small charities.

- Finance should consider a reform of the disbursement quota that **only effects the elite of large charities** with non-charitable assets over \$1 million.

Charity size	Australia	UK
Small charity	Annual revenues under \$250,000, financial statements are optional but encouraged.	
Medium charity	Annual revenues of \$250,000 - \$1 million. Audit or notice to reader.	Up to £1 million in annual income.
Large charity	Annual revenues of over \$1 million. Audited financial statement required with annual filing. With additional specific requirements for reports.	Income over £1 million or gross assets over £3.26 million and income over £250,000. Full audit required.

IN ADDITION

C. Improve data quality and timeliness for effective tracking.

Effective immediately, we recommend:

- **Canadian large charities be required to submit their T3010 electronically.** This gives you three benefits.
 1. **Timely tracker:** it will give you timely data to monitor the effect of any change in the disbursement quota.
 2. **Accuracy:** Electronic filing should improve the accuracy of T3010 data.
 3. **Reduce costs:** It is another step that will reduce the burden on the Charities Directorate. Given the generous benefits charities receive, large charities should shoulder more of the responsibilities of being transparent and accountable.

- **Canadian large charities by required to submit audited financial statements.** ACCS's submission calls for more detailed disclosure on restricted funds, endowments, and carry-forwards. These details are already covered by accounting standards and would be provided in audited financial statements. As in other countries, large charities pay for their own audit. The work and cost of detailed financial reporting would be paid for by the foundations rather than putting more work, and cost, on the Charities Directorate.

We are fans of better data quality and support Canadian Charity Law's call for more detailed T3010 disclosure. Our concern is that delays in implementing this should not hold up raising the disbursement quota immediately.

IN ADDITION

D. Eliminate ineligible disbursements.

A private foundation's grants are ineligible for the disbursement quota if granted to:

- another private foundation, or to
- a donor-advised public foundation.

This existing rule needs to be emphasized and enforced. The foundation's directors are responsible for knowing the rules. The 110% financial penalty would apply if such transfers to ineligible charities are included in the disbursement.

E. Professionals are responsible for their education.

The ACCS's submission recommends that the CRA should educate accountants and professional advisors on accurately filing the T3010. This is not the CRA's job. The CRA's job is to make and enforce the rules. It is the professional responsibility of accountants and professionals to educate themselves and know the rules. Large foundations will hire the competent professionals as needed.

F. Counter-factual – the unknown impact of investments

The ACCS's submission raises concerns about the effectiveness of additional spending. If the disbursement quota is raised, will this spending have impact? Will it do the most good for vulnerable populations? Additional spending will certainly have more social impact and do more good than growing in a financial account.

G. Double-counting of assets

Similar concerns are raised about the double-counting of a foundation's assets. We have not seen examples of double counting.

SOURCES

Advisory Committee to the Charity Sector, [Submission to Finance Canada on Disbursement Quota Reform](#), August 31, 2021

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NECESSITIES

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