THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

June 15, 2021

Via email: Chrystia.Freeland@Parl.gc.ca

The Honourable Chrystia Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Ms. Freeland:

Re: Public Consultations on Disbursement Quota applicable to Charities

On behalf of the Canadian Bar Association's Charities and Not for Profit Law Section (CBA Section), we are writing you about the 2021 Budget proposal[1] to launch public consultations on potentially increasing the disbursement quota (DQ) and updating the Canada Revenue Agency's tools to enforce DQ requirements.

The CBA is a national association representing over 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. We promote the rule of law, access to justice, effective law reform and provide expertise on how the law touches the lives of Canadians every day. The members of the Charities and Not for Profit Law Section practice in all areas of charities and not-for-profit law and in every size of practice.

The CBA Section is concerned that raising the DQ in a low interest environment will be challenging for many charities. The DQ was reduced from 4.5% to 3.5% in 2004 because it was difficult for charities to meet the higher threshold. The 2004 Budget Plan[2] stated:

> Budget 2004 proposes to replace the fixed 4.5 per cent disbursement quota rate with a new rate that is more representative of historical long-term real rates of return earned on the typical investment portfolio held by a registered charity.
>
> Given the ongoing nature of charitable activities, it is appropriate to allow charities to maintain a capital asset base on a sustainable long-term basis. Accordingly, the disbursement quota rate on capital assets should be set at a level that can sustain the real value of a charity's capital assets over the long-term. This is consistent with the long-term intentions of donors who provide gifts in the form of endowments.

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1 Budget 2021, Government of Canada, www.canada.ca/en/department-finance.html

2 Budget Plan 2004, Government of Canada, www.budget.gc.ca/pdfarch/budget04/pdf/bp2004e.pdf

> Analysis indicates that the current 4.5-per-cent disbursement quota rate is high relative to long-term investment returns. Accordingly, the budget proposes to reduce the 4.5-per-cent disbursement quota rate on capital assets to 3.5 per cent. This rate will be reviewed periodically to ensure that it continues to be representative of long-term rates of return. This change will apply to taxation years that begin after March 22, 2004.

The Bank Rate in March 2004 was 2.25%. The Bank Rate today is 0.5%. The investment rate continues to be a relevant issue for charities with endowments subject to capital payment restrictions and must be considered. Many proponents for change adopt a total return approach which enables charities to spend from capital appreciation. In other words, for many, raising the DQ back to 4.5% or even higher would require spending capital as well as interest and dividends to meet a higher DQ.

Many funds within charities restrict spending on more than income which, under trust law, is only interest and dividends (not capital gains). Capital, including capital gains, cannot be encroached on and spent in those trust funds because there is a legal prohibition on encroachment of capital which, if violated, amounts to a breach of trust. Court applications to vary the terms of these trusts would be required to expend capital, including capital gains. However, applications to vary are costly. Even the streamlined process to avoid court applications in some provinces, such as Ontario, is challenging and the constraints on permitted variations are strict.

The CBA Section believes that imposing a higher DQ expenditure does not consider the charities' need to maintain a capital asset base for the long term. This change could not be implemented without an actuarial analysis to fully understand the need for it, the impact of a higher expenditure requirement, and how it would erode the charities' capital base.

Charities cannot plan if they don't know whether and to what extent annual funds are available to fund existing and future programs. Investing charitable funds prudently to allow funds for current activities yet conserve the investment portfolio value against inflation will be challenging. Incentivizing riskier investment (which may be problematic under provincial or territorial trust law) to satisfy requirements that are not otherwise possible to meet puts the long-term base at an even greater risk.

The CBA Section was involved in the last rounds of DQ reform proposals and therefore has a deep sense of its history and evolution. We look forward to working with you in the consultation process to ensure that these issues are tabled and considered to address your concerns in a way that is beneficial to the charitable sector and the public interests that it serves.

Yours truly,

(original letter signed by Julie Terrien for Florence Carey)

Florence Carey
Chair, CBA Charities and Not-for-Profit Law Section

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