THE MUTTART FOUNDATION

Consultation on the Disbursement Quota

26-29 October 2021
Banff, Alberta

A Summary of the Discussion

This report is a summary of one of a series of periodic discussions convened by the Muttart Foundation on voluntary sector regulatory issues. The session was held to promote an exchange of ideas and to develop a fuller understanding of the concerns of both sector groups and government regulators. Any remarks included in the report are intended to reflect the discussions. No undertakings or commitments from either regulators or sector participants are expected or made, notwithstanding any of the wording in the Report.

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DAY 1 – AM

INTRODUCTIONS

The facilitator welcomed participants to the Muttart consultation on the disbursement quota (DQ). This discussion is taking place in the context of a consultation that was launched by the Department of Finance Canada in August 2021 on potentially increasing the disbursement quota and updating the tools of enforcement at Canada Revenue Agency (CRA's) disposal.

Participants were asked to introduce themselves and to share their reactions upon receiving this invitation.

Reactions were mixed, with some expressing initial concerns about attending an in-person event after meeting virtually for so many months during the pandemic.

Other general comments we heard:
- There is no consensus on this topic. We need to hear the range of viewpoints.
- Great opportunity to see and be with people for three days.
- A working group met 20 times on this issue so it will be helpful to compare perspectives.
- It will be interesting to learn of the thinking behind the government consultation.
- There is a similar debate currently going on in the US about donor advised funds.
- An interesting conversation and a good intellectual exercise.
- Delighted to be part of a Muttart consultation because this is a difficult and challenging issue.
- Eager to participate.
- A good opportunity and looking forward to hearing various viewpoints.
- A hot and heavy discussion is likely. Media interest is strong.
- Wonder if there is enough content to discuss over a three-day period.

The facilitator then reminded participants about a few process rules:
- No cellphones or computers during the sessions. Breaks will provide ample time to make calls and check emails.
- Please always use microphones when making an intervention.

- Chatham House rules prevail.

BACKGROUND/CONTEXT

To kick off the discussion, a representative from the Department of Finance was asked to provide background information about the DQ consultation. The following key comments were made:

- The Federal Government's 2021 budget included an announcement on consultations about potentially increasing the DQ and updating the tools for enforcement. It is estimated that doing so could lead to increased resources to the sector, in the range of $1 billion to $2 billion.
- A background paper was released in August 2021. It was noted that the consultation process was affected by the subsequent federal election call.
- Some of the key questions posed in the paper:
  - Should the DQ be raised and to what extent?
  - Should it be raised to a level that could lead to encroachment on capital and would that be sustainable?
  - What additional compliance tools should be available to the CRA?
  - Should we take a longer-term view or should we focus on the short-term to deal with the impacts of the pandemic?
- About 120 charities responded with written submissions. Most were unique responses, of significantly high quality, and not endorsements of the positions of others.
  - Responses were evenly split between those for and against raising the quota.
  - Those opposed were for the most part, individual private foundations, expressing concerns about their ability to exist in perpetuity.
  - For those who proposed an increase, the primary argument was the need to increase funding for charities now. They cited investment returns being higher, an overall increase in assets, and they downplayed the concerns that foundations expressed about sustainability.
  - A number of respondents were neutral and cited the lack of data as a reason for taking a more cautious approach.
- The Department of Finance is currently reviewing and analyzing the submissions. Some are detailed with unique data points. They are also doing their own data analysis. Their own research is showing that there are significant data quality issues. Also, the information submitted by charities is not necessarily unreliable but problematic in that there are data gaps. And one charity skews the overall results.
- It was also noted that the Department of Finance has little data and information pertaining to endowed properties.
- Private foundations, especially larger ones, seem to see the 3.5 % DQ as a ceiling, and not a floor.
- There is agreement in the Department that the sector as a whole is meeting their disbursement quota. The issue is more at the granular level of individual foundations.
- The Department is wanting to strike the right balance between two competing objectives: deploying resources on a timely basis to make more funding available to charities now and finding a rate that will ensure future resources are available.
- Other themes emerged from the submissions:

    - The need to consider other changes, especially on the matter of direction and control. Charities are limited to only funding qualified donees.
    - Disparities in funding to large charities and to smaller grassroots organizations.
    - Impact investing and solutions for disbursement quota purposes.
- The Department will present its options to the government before the 2022 budget.

A representative from the CRA was then asked to provide its perspective on enforcement tools and the data problem. The following comments and observations were made:

- Data quality is an issue. There is both missing data and inaccurate data.
- Quantity is also an issue. Charities are already challenged by requests for existing data, without asking them for even more information. 70% to 75% are small and don't have the capacity.
- There are lots of options and suggestions about fixing the data problem:
    - Digital intake is key. We need to get away from paper submissions. So far, there is about 25% uptake on digital returns.
    - Validation fields are needed so that people can't leave some responses blank when filling in the T3010.
    - Artificial intelligence programming that catches differences with previous data provided by a charity will help to improve accuracy of reporting.
    - Would like to see a volunteer program to solicit people who will help other charities do their filing.
- As for enforcement, there are questions about the real scope of the problem. Is it an error in reporting or a lack of ability to meet the quota?
- More resources would be needed to enforce the DQ. Currently, they don't audit on the DQ alone. Adherence to the DQ is looked at in the context of an overall audit. Enforcement of the DQ alone would lead to a fragmented audit system.

Q&A ON THE BACKGROUND AND CONTEXT

Participants were invited to ask questions of the presenters.

Q. Under the Act, is filing an incomplete return the same as filing no return? Does that lack of information generate a letter that reminds the charity that their return is incomplete?
A. CRA could do that, but they need a way to address all the information gaps in any return. Focusing on increasing uptake of digital returns is a preferred strategy at this time.

Q. Should we be addressing the other issues that were raised in the submissions to the Department of Finance?
A. It's best to just focus on the disbursement quota - the rate, the specific rules, enforcement, and other mechanics of the *Income Tax Act*; suggest we stay away from issues of direction and control and social finance as part of this discussion.

Q. It's been 17 years since there was a change to the DQ. Is there need for a more regular review? Did anyone ask about this in the submissions?
A. This was mentioned in quite a few submissions. The Finance Department indicated they would be open to doing a review every 5 years.

Q. There is a lack of data and no consensus about raising the DQ. Is there a methodology for problem solving here? Is this about tax law or charity law? The percentage needs to be grounded in principles.
A. Finding the right balance between competing objectives is challenging but the data is not so bad that Finance can't do an analysis. They are doing an analysis that is similar to that done by Imagine Canada. There is the possibility of a graduated rate for different sizes of charities. The asset lock on property is a particular challenge. There are provisions that can be used in tax law to reduce the disbursement quota. From a tax perspective, we are limited in terms of the tools. There are generous provisions: how long does it take for the money to make its way to the sector? Fifty years may not be the best answer.

Q. What is the impetus for this change? Pressure to spend more because of the pandemic? Privileged money that is retained in perpetuity? Is it possible to not provide a recommendation?
A. The pandemic was a big challenge for the sector and many struggled. Government wanted to see what could be done from a tax perspective. There were issues and articles in the news about increasing disbursements from foundations. A non-response is not possible, but they could recommend taking more time to study the issue.

Q. What are the merits and the basis of this discussion? How much of it is about the ideology of the sector providing services to the public? Is it not about collecting money from taxpayers and distributing it in a timely manner? The DQ is then a red herring. Holding dollars back for 50 years makes no sense.
A. There is a recognition of the work done by the sector. At Finance, we ensure that the rules around DQ are appropriately supporting the sector while recognizing the need to support sustainability of the foundations. They are also aware that charities need funding now to avoid bigger social problems down the road. They are seeking to strike a balance and not taking a philosophical perspective.

Q. Did think tanks, taxpayer associations chime in on this issue?
A. Mostly charities, foundations and those that represent the sector provided submissions. Few were received from individuals and taxpayers. Organization watchdogs did submit their views as well.

Q. DQ is a lightning rod for other issues. There is a need for enabling conditions about direction and control. Are there concerns about a negative response from the sector if these other issues aren't addressed?
A. Those other issues like direction and control can't be escaped. Finance is aware of that issue and flags it with the government but is sticking to DQ issues for now.

Q. What are the enforcement tools that CRA has and what more does it need?
A. Focus is on enforcement for those that won't respect the DQ and that is part of the audit assessment already. Education first has been the way to go. CRA has road shows, webinars, website information and help on the phone to charities that call in. Significantly more resources would be required to improve data and enforcement measures.

Q. Did anything surprise you in the submissions?
A. We were surprised that the balance of responses was 50/50. We also expected more submissions from operating charities. Another surprise was the mention by foundations of impact investing and program related investments.

Q. Asset accumulation and size of organization is a data point. Are you also looking at smaller charities and their resources? What about the churn rate of the donor dollar?
A. Finance is looking more broadly at effectiveness and efficiency of the tax system: are we getting an equivalent benefit from the tax measure? Should dollars be provided to the sector in a timely way or not?

While it wasn't a question per se, it was noted that foundations currently benefit from past tax expenditure decisions and what is gifted is the income stream.

INTERNATIONAL PERSPECTIVES

The international participants were then invited by the facilitator to comment on how the DQ is handled in their jurisdictions.

England and Wales

- There is no disbursement quota and no separate laws for foundations- it's not a legal term. Funds held in perpetuity are referred to as permanent endowments in the UK.
- Biggest difference is that the Charity Commission doesn't regulate from a tax perspective. It is based on charity trust law.
- Regarding concerns that foundations are hoarding additional funds: fifteen years ago, it was decided that all charities need a reserve policy. They have to explain why they are holding additional funds and how much they hold. This information is part of the annual return and part of the public record. The Commission provided guidance on the reserve policy. Charities are expected to work from high level principles of charity law such as duty of care and the duty to further charitable principles. They are expected to take a reasonable approach.
- When it comes to enforcement, the Commission can and does take action if the charities are not disbursing appropriately. The Charity Commission is a quasi-judicial body, so it has some of the power of the courts.
- In 2006 the *Charities Act* allowed for charities to spend down their permanent endowments. They can go to the Commission to ask to spend down their endowments. Charities are also able to borrow against their capital.
- There is no figure on total assets held in permanent endowments.
- In 2008 there was interest in a DQ but it petered out on the agenda.
- As for responding to the pandemic, foundations got together and put out a statement to say they are listening, learning and there for the long term. Most of the charities focused on using funds disbursed by the government and did not clamour for more resources from foundations.

Q&A ON THE UK/WALES PRESENTATION

Q. What does the Commission consider when it gets an application to spend down?
A. Impact on present versus future beneficiaries is the biggest consideration. A number of cases are going through now.

Q. Is there any sense of the assets being disbursed?
A. No. A report is coming out soon on the issue of the lack of data about charities.

Q. Did the Commission ever take action on foundations with large endowments that aren't spending?
A. No. The Commission hasn't taken much action on foundations. There is very little guidance on the matter except for corporate foundations.

Q. A lot of money in historic trusts comes from colonial actions. Has there been a call for more disbursements from those trusts?
A. Yes, there is a call for more dollars from those foundations.

United States

- In US tax law there are rules for public charities and for private foundations. Public charities are not subject to any fixed payout requirements, but they could lose their tax-exempt status if they are only accumulating dollars with no plan to spend. A number of organizations fail that test, but it creates a secondary market of charities who want the tax exemption. These charities can go dormant and hide from the IRS and are then sold to the highest bidder.
- In the 1950's a study of private foundations was done. It went to the House Ways and Means Committee. The focus was on private foundations at the time. A finite life of 20 years was proposed but they settled for a tiered excise tax system instead. The statute requires private foundations to pay out 5% of their assets each year, but assets can be paid out in various ways. A failure to pay out 5% in the year that follows results in a penalty excise tax that is 30% of the dollars that should have been spent. The next year it rises to 100% and if that doesn't work, the government seizes all assets.
- Calculations of payouts are not simple and require disclosure of all assets such as stocks, etc. Foundations are educated on how to do the calculations. The debate is mostly on the margins, about issues such as program related investments. Few organizations end up paying the excise tax. Robust education has contributed to higher levels of compliance.
- Payouts may not be to charities, as they can include administrative expenses like offices, compensations of CEO, etc.
- The 5% payout has not crippled the endowment of foundations. They have high rates of return.
- In the US, retribution has driven the payout discussion. For example, Trump levied a tax on large endowments of universities that don't pay down.
- At one time, medical research organizations were forced to comply with a 3.5% expenditure rate on medical research but couldn't spend it fast enough to meet their payout targets. They hired doctors around the world to become deputized 'Howard Hughes' medical research entities.
- For private foundations, the spend rate seems to have been accommodated but some very larger foundations have had difficulty spending their payouts wisely without wasting money.
- The more prevalent issue is about payout of donor advised funds (DAFs). Some of the DAFs are the largest charities in the US. Senator Grassley has championed the anti-DAF movement but the Senate Finance Committee has been unable to come up with a rate. It festers along with the issue of large university endowments. For some foundations like Harvard, they would have to buy subsidiary colleges to meet a 5% payout, which could lead to concentration of power in the post-secondary education sector.

Q&A ON THE US PRESENTATION

Q. Do most private foundations pay 5%?
A. Yes, there is a cluster where most payout 5%. The other option is to spend themselves out of existence. 5% was chosen as a high enough rate, but not so high that it would mean borrowing when returns are low.

Q. Does a higher payout rate conflict with the concept of a prudent investor?
A. It has not forced foundations to be aggressive in their investing, except for those with large assets, such as major universities, hospitals etc. Some use offshore investment vehicles with no tax on corporate income. Sophisticated institutions are able to make their payouts. Problem is more rooted in self-dealing in investments. Borrowing dollars to meet payout did happen in the stock market crash. Rather than liquidate securities that were low, they borrowed and the interest on those loans was deemed part of the disbursement quota.

Q. Are private foundations flipping dollars into their own DAF accounts?
A. Yes it happens.

Q. Is a 4% admin and 1% payout ok in the US?
A. Yes, but it is more likely to be the case of a service-providing facility like a soup kitchen and less so for private foundations.

Q. The historical real rate of return was 3.5% in 2010 and was deemed a good number because it wouldn’t erode capital. 5% may lead to slow drip of capital over time. Has this come up in the US?
A. An analysis of 5% was done and it did not result in the loss of capital. The investment returns are higher than they expected. The percentage number is not focused on a mathematical calculation. It’s pretty much a policy call that is only loosely based on a formula.

Q. The conversation now in Canada is about unlocking resources in an extraordinary time. Is there a similar pressure in the US?
A. Yes, but the focus right now is on DAFs that don't have a specific payout. Private foundations are public about what they do in the US. This has defused greater calls for more payouts.

Q. Private foundations sometimes run their own programs. Is that the same in the US?
A. Yes, for example the Ford Foundation issues bonds. This adds complexity because they need sophisticated investors.

Q. Admin expenses do not count towards the disbursement quota in Canada. What happens in the US?
A. Costs foundations incur in doing their granting are not administrative costs; they are charitable costs. So, a board meeting is a charitable cost and not an admin cost. There is some dispute about this issue. In the US some states are more aggressive than others in chasing down foundations that have high admin costs.

Australia
Because there was no representative from Australia at this session, it was simply explained that there are two different rates of disbursement: 4% for community foundations and 5% for private foundations.

DAY 1 – PM

A DISCUSSION ON WHAT QUESTIONS NEED TO BE CONSIDERED

The facilitator called upon the participants to brainstorm about what questions should be considered and discussed over the course of the consultation. A long list of potential questions was developed through the brainstorming process. The group was then invited to consider the long list in small breakout groups to determine what the top 3-4 questions would be most important to discuss.
The five break out groups met and provided their respective feedback to the full group. From these group summaries, the facilitators developed the final list of questions that would be discussed over the course of the presentation. They are presented below in order of importance.

1) What is the problem we are trying to solve? Or what is the problem government is trying to solve?
2) Can we reform all 3 design features of the disbursement quota (DQ)?
    a. The rate, either fixed or floating
    b. The base (what's included in the base for calculation purposes vs. suggestions for change)
    c. The qualifying expenses (what is currently allowed vs. suggestions for change)
3) What is weighting of capital accumulation vs. spending?
4) Can we anticipate unintended consequences of any changes?
5) Who does DQ apply to (donor-advised funds, private foundations, trusts)?
6) What information does CRA need to track, monitor and enforce the DQ?
7) What is a sustainable rate for foundations?
8) How can DQ complement trust law principles?
9) How do you make the rate the "floor"; should we consider fiduciary spending principles?
10) How do tax expenditures inform the DQ reform?
11) What other factors/considerations should be discussed to further a broader policy conversation (i.e., funds in perpetuity, responding to needs of vulnerable populations, colonial wealth, etc.)?

The facilitator pointed out that there was consensus from all groups about discussing the first four questions, while the others were raised by only one or two groups. The issues raised in questions 5 to 11 were likely to be brought forward in the conversations relating to the first four questions and would be taken into account.

DAY 2 – AM

The participants were welcomed back to day 2 of the consultation. The meeting then began with providing the context for the current government consultation on the disbursement quota.

- The COVID 19 pandemic has created funding challenges for charities and many of these charities have reached out to government asking for sustainable/stabilization funding.
- Government has been exploring what resources the sector currently has to draw upon.
- Foundations have accumulated assets – can some of these be used (at no cost to government) to provide funding to charities?
- An increase in the DQ could significantly boost support to the charitable sector benefitting those most vulnerable in Canadian society.
- Furthermore, there is an issue of enforcement of the DQ.
    - In 2019 alone – there is an estimated $326 million that hasn't been spent by Foundations on the DQ
    - The estimated cumulative over 5 years of unspent DQ is $1.5 billion (this includes one very large foundation)

The discussion on the first question identified began. Participants were given some time to think of their responses, and the input below was provided.

Question 1 – What is the problem we are trying to solve? What is the purpose of the DQ?

- The question was raised as to whether the problem is that the DQ is a bad policy. Should foundations be encouraged to spend down rather than accumulate?

- If the policy goal is to increase funding to the sector, the question is whether increasing the DQ would achieve that goal. Is increasing the DQ the best way to counter inadequate funding to the sector?

- We don't yet have data that clearly shows the impact of the pandemic on the sector, which makes it difficult to know if an increase in the DQ will be enough. Depending on the decision and the timing of an increased DQ, the timing of providing increased dollars to the sector may not work.

- We must consider whether COVID is a transitory issue. If it is, why would we change the law? If it isn't, there is a broader issue to be considered by the sector related to how the sector will adapt.

- Knowing the "state of the sector" as a starting point would be helpful. This would provide information as to whether increasing the DQ would, in fact, provide the resources required.

- The premise of the consultation is wrong (i.e., increasing the DQ will provide resources to the most vulnerable). Only 2% of the sector's revenue comes from foundations and changes to the DQ won't direct "where" the increased dollars will go.

- Perhaps the better conversation would be a broader one: "What is the state of the Charitable sector's economy"?

- The CRA is not enforcing the current DQ. How will they be able to enforce an increased DQ? If the DQ is raised AND enforcement occurs – this could bring substantial resources to the sector – but may still not be the full solution.

- We must consider the potential negative impacts on Foundations. Would an increased DQ mean that some foundations would be encroaching on their assets?

- Although it is true that an increased DQ will not necessarily provide funding to those who are most vulnerable, this is not a good rationale for not making the change.

- Part of the debate is about issues related to perpetuity and the need to spend dollars vs. accumulating capital. Some participants feel that endowments were meant to be for a "rainy day" and…the pandemic has meant that "it's pouring rain". Others feel that if we spend more today, there will be less available tomorrow and that endowments have always been about paying it forward. It's difficult to anticipate what the next crisis will be, but many felt that there would be more challenging times ahead.

- When thinking about the whole ecosystem of the charitable sector, a number of questions/issues arise. Inequity exists with fewer foundations acquiring more dollars; it is important to consider the health of the ecosystem vs. the existence/health of individual foundations.

- Although the current DQ rate of 3.5% is meant as a minimum, it is often interpreted as a goal. This has meant that many foundations are growing faster than the rate of inflation. Considering a formula-based DQ (rather than a set rate) could help with this issue.

- While it is important for government to regularly review the DQ, we need to be concerned that regular reviews could lead to DQ increases only.

- Government should consider "what", beyond potential increases to the DQ, would bring more resources into the sector.

- Almost all submissions highlight the need for better data (quantity and quality). Many comments and suggestions are currently based on perceptions rather than on evidence.

- Consideration needs to be given to the CRA's capacity for enforcement. Could there be consideration given to self-enforcement? Note: CRA is looking at increasing digital filing and using validation tools.

In summary:
- Government and others see an increase in the DQ as one way to increase resources to the sector
- COVID context is transitory, and the biggest need is in marginalized/vulnerable groups; many questions as to whether new dollars would go to charities that need it most
- Consideration needs to be given to balancing the accumulation of capital against spending of assets
- Discussions about potential unintended consequences need to be held
- Data currently available is limited and unreliable

CRITERIA/PRINCIPLES AND FORMULA DISCUSSION

Before considering potential rates and/or formulas, the participants brainstormed what the principles/criteria could be for establishing a base. The following suggestions were offered during the discussion.

- Ensure that the DQ is protected from being politicized (concept of neutrality).

- Perpetuity should be permitted; but avoid funds being held in perpetuity by inadvertence; consider if perpetuity for no reason is a problem. Planned perpetuity may be acceptable; how do we preserve capital? What could a sustainable ratio be?

- There is a need to educate donors about perpetuity.

- The concept of 'delayed good is less good' was discussed; many participants felt that this statement needed to be nuanced as it may not always be true. Another view was expressed that there is a need for balance between doing good now and doing good in the future.

- The principle of "simplicity" is important. The DQ needs ease of communication, ease of understanding, and ease of implementation.

- If the capital assets of foundations need to grow, a reduction in the DQ is needed. If capital assets need to be maintained in perpetuity, the DQ probably needs to be maintained at the current rate. If the capital assets of foundations need to be spent over time, an increase of the DQ is required.

- Foundations must maintain autonomy/independence; there is a need to provide education to foundation board members; build increased trust in foundation boards.

- Foundations have an obligation to meet their respective charitable purpose.

- Three concepts that may be guiding principles: Altruism, Action (i.e., consider changing the Act to add the word “actively”) and choice.

- Should the DQ apply to individual Donor-advised Funds (further discussion related to this topic later in the report).

Beyond a simple increase to the rate of the DQ, the participants reviewed and discussed two formula-based approaches:

Formula-based approach as submitted by Vancouver Foundation

- Sustainability ratio would be the market value of their funds divided by inflation adjusted contributions. In the perfect scenario, this would be targeted at 100% meaning that the foundation has balanced the needs of the present with a provision for the future. Anything over 100% implies that the foundation is short-changing the present (i.e., holding more than needed). A number under 100% means spending happening today is at the expense of future grants.

Formula-based approach as submitted by one of the consultation participants

- DQ = R – CPI – 1%
- R is equal to the returns on referenced portfolios (annualized over 10 years)
- Example: 30% with TSX; 30% with S&P 500; 40% Canada Bonds
- In the example above, the return is at 7.13%, the CPI is at 1.58
- Therefore; 7.13% minus 1.58% minus 1% = DQ of 4.55%
- This could be reviewed every 5 years

The participants then outlined which principles/criteria would be maintained if either of the formulas (above) were implemented.

- The concept of perpetuity/sustainability is permitted (and is in fact the “minimum” or floor).
- Capital accumulation beyond preserving initial capital is not permitted (and is in fact the “maximum” or ceiling).
- The DQ formula would allow foundations to be able to predict the rate and this rate/formula would be made public.
- The formula could be reviewed every 5 years and the returns on referenced portfolios would be based on 10 years of data.
- This approach would not be subject to changing political priorities.
- This approach allows a balance between doing good now and in the future.
- The formula-based approach allows for both transparency and accountability; it also allows foundations to maintain autonomy.

DAY 2 – PM

EXPLANATION OF TIERED FORMULA FROM IMAGINE CANADA

As part of looking at different formulas, the discussion moved to the Imagine Canada submission, which proposes a scaled disbursement quota based on their inclusion in categories as determined by asset size and designation. For example, the minimum threshold of 3.5% could be maintained for smaller organizations (those under $1 million in assets) and range upwards in the area of 7% and beyond for larger organizations.

The following comments, questions and observations were made:

- A review of 7 years of data sets confirms a 3.5% disbursement rate. They cluster at 3.5%, although some are at 3.35%. Some foundations seem to see the rate as a regulatory requirement and misunderstand that they can disburse more.
- All routes to regulatory compliance are normative. The question is how to encourage foundations to go beyond the 3.5% floor. There is already guidance provided by CRA to educate charities that the DQ is not the ceiling, but a floor.
- There seems to be no correlation between foundation size and DQ rate, but there may be a correlation between rate of return and DQ rate. Submissions to Finance seem to support the latter. There is also no data on large foundations and their capacity to increase their DQ.
- Small organizations need to be taken into account. A tiered approach would help but T3010 changes would be required.
- Smaller foundations could have larger ones manage their assets but it’s complicated. Although it could increase their returns, issues arise like respecting provincial securities law, assets belonging to the larger foundations, different incorporation status and a preference for hire local investment managers.
- Is there potential for abuse in a tiered approach? Attempts to move to a lower rate? Avoidance behavior by writing two cheques instead of one? What are the unintended consequences of a tiered model? Smaller charities may not have the same avoidance behaviors. Risks could be greater for larger foundations.
- Remember that DQ shouldn’t really apply to charities. Most disburse 100% and designated status (charities, foundations, etc.) may not be appropriate. Some foundations run programs and their expenditures contribute to the DQ.

UNINTENDED CONSEQUENCES OF A FORMULA FOR SETTING THE DQ

- The R factor is a problem. It brings more complexity, more compliance and communication challenges. Could be confusing for foundations and there would be lobbying on the R factor.
- There is no data about how much is currently invested in program-related investments (PRIs). Demand for them is not strong so they should be taken out of the asset base. The model portfolio excludes PRIs from the mix.
- If we want to incentivize foundations to give more, which formula works best?
- There could be more/different types of funds that could incentivize disbursements over the DQ.
- The DQ did not affect an increase in the number of DAFs.
- Concerns were expressed about mission related investments and impact investing, as it could lead to pursuing non-charitable activities with charitable dollars.

- The issue of trusts is problematic for the formula model.
- Need to consider the impact of a formula on foundations that now give above the DQ rate. Moving to a formula could decrease resources going to charities in the short term. The Pemsel Case Foundation research shows that a DQ rate change can affect behaviors. There is the possibility of lower disbursements for higher donors.
- Predictability of the rate is a double-edged sword: upcoming increase in a DQ could lead to lower disbursements now.
- No data currently exists on different types of foundations and their compliance behaviors.
- Are existing funds for charities adequate? Can more support go to operational charities? Hospitals and universities are favoured, and vulnerable communities may not be the beneficiaries of an increased DQ.
- Incentivizing the public to give to vulnerable communities may be a more effective strategy than a DQ raise.
- Equitable giving is impacted by qualified expenditures, not by the rate.
- Incentivizing foundations through the DQ won't likely impact operating charities. Direct funding is preferred and more impactful.
- Need to remember that any new dollars flowing to existing organizations will be of benefit.
- Avoid scenarios that create gamesmanship. Simplicity works.

CRA ISSUES REGARDING ENFORCEMENT AND DATA COLLECTION

- Using a formula would require more data capture and potentially make it more complex for CRA to enforce.
- Currently non-compliance measures go from education to revocation. No charity has ever been revoked solely for not complying with the DQ. Organization suspension by CRA is a tool that could be considered.
- We need to differentiate filing from post-filing assessments. There is currently no penalty to charities that don't file properly but perhaps we need one.
- There is no reliable data on the DQ – much of it is missing or incomplete so we are unable to use the data in a meaningful way to make evidence-based decisions. CRA looks at DQ data from a risk assessment lens only. This is an opportunity to increase the quality and quantity of information collected. The Finance Department is interested in ensuring that tax incentives/measures are effective. Data needs to be collected to that end.
- Every charity could complete a schedule on the DQ, which would provide more information. Prior to 2010 there was a companion worksheet as part of the T3010. Worksheets are still available to calculate disbursements.
- Data on expenditures and lists of investments are two different things. Providing lists of investments raises different issues – e.g., endowed properties, impact investments. Is there a need for a confidential schedule on investments?
- Under 100 organizations a year get disbursement relief from CRA. Discretionary relief provisions can create perceptions of non-compliance. Trusts don't get relief provisions from CRA.
- As said earlier, sector uptake on digital filing is slow. It's an issue for the CRA but it's also an issue for the sector. Imagine Canada and umbrella organizations can push e-filing. Could digital filing be made mandatory? Should it be harder for charities to get a paper version? CRA is working on this.

- Lots of effort is required to help charities get the information they submit right. Blank fields are now flagged by CRA staff with the charities. Having tombstone data and year over year comparisons could incentivize charities. Online toolkits are being developed by CRA to help them as well.
- Are charities treated differently from businesses and individual filers? Incentive for tax filers is quickness of the response – i.e., a refund. There are no such incentives for charities.
- Can banks send information to the CRA about their charity clients' investments? IRS in US asks for much more information from charities than we do. And returns are public.

Day 3 – AM

Participants were welcomed back to the last day of the consultation. Participants were asked to reflect on "what constitutes the base" for the purpose of the DQ calculation.

The session began with what is currently defined as the "base" and how the DQ is calculated.

The information below is what is currently defined by the CRA:

- The disbursement quota is the minimum amount a registered charity is required to spend each year on its own charitable activities, or on gifts to qualified donees (for example, other registered charities). The disbursement quota calculation is based on the value of a charity's property **not** used for charitable activities or administration.

For the purposes of calculating the disbursement quota, property includes any real estate, investments, or other assets that were **not** used directly in charitable activities or administration. This may include, for example, cash in bank accounts, inventory, stocks, bonds, mutual funds, GICs, land, and buildings.

The participants then reviewed program related investments as part of the base.

The CRA defines PRIs as follows:

- Program-related investments (PRIs) may be charitable if they directly further one or more of the charitable purposes listed in paragraph 11. A PRI is an activity that directly furthers the investor charity's charitable purposes. Common types or forms of PRIs include:
  - loans
  - loan guarantees
  - share purchases
  - leases of land or buildings

- A PRI is not an investment in the conventional financial sense. While PRIs may generate a financial return, they are not made for that reason. A PRI usually involves the return, or potential return, of capital (funds or property) within a set period of time, but this is not a requirement. A PRI may also yield additional revenue for the investor charity (such as interest), but the yield of additional revenue can be below market rates.

- A charity could often simply fund a PRI-related activity outright because it furthers one of its charitable purposes. However, a charity may decide to invest capital with the expectation of it being returned with or without yielding additional revenue for various reasons. For example, a PRI can increase the benefits a charity can provide when the invested capital or property is returned (such as repaying the principal or ending a lease), or yields additional revenue (such as interest on a loan) as these funds or facilities can be used or re-used to support other charitable activities.

The following comments were made by participants:

- The issue of 'direction and control" only applies if the gift is made to a non-qualified done.
- Not all PRIs are mission related.
- PRIs must be to further the charitable purpose.
- When PRIs were first introduced the opportunity cost was the same as a grant but now this only applies if the foundation does not meet the DQ.
- Referring to the ITA 149.1 and regulation 3702 will provide additional relevant information.

QUALIFYING EXPENSES

- Administrative and investment expenditures are between 0.5% and 2% with most around 1.5%. This is information gleaned from the submissions.
- In the US investment expenses are excluded from qualifying expenses. IRS has challenged high administrative expenses in the past.
- Administrative expenses could be allowed but offset by a 1% increase to the DQ rate.
- There was a discussion about whether a charity is in breach of trust if it fundraises, as it is not a charitable activity per se. Some felt foundations should be discouraged from fundraising, primarily because it increases the competition for donors. Foundations can be fund advisors but should not be fundraisers. Community foundations do fundraise, but private foundations generally don't.
- Audits and board meetings are not deemed to be charitable activities at this time although some boards argue that it is indeed a charitable activity if that is the primary mechanism by which decisions are made about spending on charitable activities.
- We need further definition on what constitutes charitable activities from the CRA.
- All activities should be deemed to be charitable/in service of a mission.
- We don't want to increase the DQ and then allow for increases in expenditures.

CONCLUSIONS/REFLECTIONS

- This has provided me with a deeper, better understanding of the DQ.
- Riveting, engaging, informative, enlightening, and challenging.
- Exceptional and a unique experience.
- We have not addressed the needs of the underserved, but DQ is probably not the tool to do so.
- Learned much, met new people, we mostly stayed on topic.
- This reminds us of the need for evidence and data for good policy making. Appreciated validation of the gaps in data.

- Great hunger for data. Need both quality and quantity.
- We can do work on the ground to improve data.
- Look at the new initiative on data collaboration.
- We did not discuss the transition phase after a DQ rate increase.
- Struggled with disparate parts of the reference question. Would be interesting to hear from vulnerable communities. The question about getting more resources to them has not been answered.
- This is a time of great need and greater inequity.
- Need to recognize the composition of this group. Rethink our ecosystem and the greater good. Consider having non-issuing foundations.
- Appreciates continuation of these forums - this is a jewel in the sector.
- Kudos to government representatives who were here with us virtually. Their input was very informative.
- We need to act on improving the digital uptake of T3010 reporting.
- Appreciation for the format of the consultation that does not require consensus.
- There was no consensus but a good debate.
- Debates are necessary on the big issues. Not only about DQ but about wider, bigger issues.
- Appreciated the different views.
- Importance of mutual respect.
- Remain unreconciled re DQ and the purpose for making the change. Other matters are yet to be discussed, like non-qualified donees.
- Lots of info they can take back.
- Submissions that included data and analysis were particularly helpful.
- Good facilitation.
- Made progress on the DQ but wanted to talk about other things as well.
- Privileged to be at this table.
- Good conversations in and outside this room.
- Careful of us vs. them mentality.
- Thanks to the lawyers.
- This forum is an investment in the capacity of the sector.
- Operating charities are exhausted. More money needs to go to the sector.
- Philanthropy is too focused on dollars and not on the results we (charities) are trying to achieve.
- Need to educate about DQ to boards/trustees/wealth advisors.
- A special consult after 20 months of not having one.
- This session went beyond concepts to people and their stories. A helpful reminder.
- Need to learn to truly listen to one another.
- Lots of good humour and good will.
- Thanks to the government representatives. They were open minded, good spirited.
- No harm and much good can come from putting people with different perspectives in a room. They are better informed, have a better understanding even if they may not agree.

