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SUBJECT New disbursement quota rules for charities
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PRINCIPAL ISSUES: Proposed paragraph 149.1(4.1)(d) as it applies to two hypothetical scenarios.
POSITION: General comments given.
REASONS: Based on the proposed amendments.
XXXXXXXXXX

2010-037084
T. Elsey

September 24, 2010

Dear XXXXXXXXXX :

Re: New disbursement quota rules for charities

We are writing in response to your email dated May 17, 2010, regarding the changes to the disbursement quota proposed in the federal budget tabled on March 4, 2010 ("Budget 2010"). You have asked for our views on the application of proposed paragraph 149.1(4.1)(d) of the Income Tax Act (the "Act") as it applies to the two hypothetical scenarios described below:

(1) A registered charity (the "Donor Charity") plans to gift real property that is used in its charitable activities to another registered charity that is a related charitable foundation (the "Recipient Charity"). The value of the real property is $10 million. Assume that the Donor Charity will otherwise meet its disbursement quota for the year irrespective of the gift of the real property and that the full value of the real property will be designated by the Donor Charity as a "designated gift". You would like us to confirm that the Recipient Charity will not have an obligation to expend any

portion of the value of the designated gift in addition to its existing disbursement quota for the year.

(2) Assume the same facts as in the first scenario except that the Donor Charity will have a deficiency of $100,000 in its disbursement obligation without taking into account the gift of real property. The Donor Charity intends to use this portion of the value of the gifted property to meet its disbursement quota and designate the remaining value of $9,900,000 as a "designated gift". You would like us to confirm that the Recipient Charity would then have an obligation to expend $100,000 by the end of its next taxation year, in addition to any disbursement obligation it might have on its own account.

Written confirmation of the tax implications inherent in particular transactions may only be provided by this Directorate where the transactions are proposed and are the subject matter of an advance income tax ruling submitted in the manner set out in Information Circular 70-6R5, Advance Income Tax Rulings, dated May 17, 2002. This Information Circular and other Canada Revenue Agency ("CRA") publications can be accessed on the Internet at http://www.cra-arc.gc.ca/formspubs/menu-e.html. Where the particular transactions are completed, the inquiry should be addressed to the relevant Tax Services Office. We are, however, prepared to provide the following general comments.

Our Comments

Budget 2010 proposes several changes to the disbursement quota regime governing charities. In addition to proposals to repeal the 80/20 disbursement requirement and to modify the capital accumulation rule, Budget 2010 also proposes to extend the existing anti-avoidance rules to situations where it can reasonably be considered that any purpose of a transaction was to delay unduly or avoid the application of the disbursement quota. On August 27, 2010, the Department of Finance released for consultation the proposed legislation announced in Budget 2010. If enacted, these amendments will take effect for taxation years ending on or after March 4, 2010.

Subsection 149.1(4.1) of the Act permits the Minister of National Revenue to revoke the registration of a registered charity in certain circumstances. Proposed paragraph 149.1(4.1)(d) of the Act states:
(1) The Minister may, in the manner described in section 168, revoke the registration

(d) of a registered charity, if it has in a taxation year received a gift of property (other than a designated gift) from another registered charity with which it does not deal at arm's length and it has expended, before the end of the next taxation year, in addition to its disbursement quota for each of those taxation years, an amount that is less than the fair market value of the property, on charitable activities carried on by it or by way of gifts made to qualified donees with which it deals at arm's length.

New paragraph 149.1(4.1)(d) of the Act essentially provides that when a registered charity receives a gift of property from a non-arm's length charity, it will need to spend an amount equal to the fair market value of the property on its own charitable activities or transfer the amount by way of gift to arm's length qualified donees within the current or subsequent taxation year or its registration may be revoked. However, if the donor charity designates all or a portion of the gift of property as "a designated gift", this designated portion will not be subject to the immediate disbursement requirement.

The legislative proposals also include the addition of the phrase "designated gift" to the definitions listed at subsection 149.1(1) of the Act, as follows:

"designated gift" means that portion of a gift of property made in a taxation year by a particular registered charity, to another registered charity with which it does not deal at arm's length, that is designated by the particular registered charity in its information return for the taxation year;

Concurrent with the addition of the definition of "designated gift" is a proposed amendment to replace the reference to a "specified gift" in paragraph 149.1(1.1)(a) of the Act with a reference to a "designated gift".

With regard to the first scenario, since the Donor Charity will designate the full value of the gifted property as a designated gift, the Donor Charity will be precluded from using the designated gift to satisfy its disbursement quota by virtue of the deeming rule in subsection 149.1(1.1) of the Act. The Recipient Charity will not be subject to the immediate disbursement requirement in respect of the designated gift due to the exclusion for designated gifts contained in proposed paragraph 149.1(4.1)(d) of the Act.

Under the second scenario, since the Donor Charity is designating a portion of the gifted property as a designated gift, the portion not so designated may be used to meet the Donor Charity's disbursement quota. Only the designated portion of the gifted property will not be subject to the immediate disbursement requirement set out in proposed paragraph 149.1(4.1)(d) of the Act. Therefore, in addition to any disbursement obligation the Recipient Charity might have on its own account, it would have an obligation to expend $100,000 in carrying out its own charitable activities or by way of gifts to qualified donees with which it deals at arm's length in the current or subsequent taxation year.

We note that the proposed amendments to paragraph 149.1(4.1)(a) and existing paragraph 149.1(4.1)(b) of the Act can subject donor and recipient charities to revocation of their registration if it may reasonably be considered that a purpose of the transaction was to avoid or unduly delay the expenditure of amounts on charitable activities. Whether any purpose of a transaction is to avoid or unduly delay the expenditure of amounts on charitable activities is a question of fact and must be determined on a case-by-case basis.

While we trust that our comments will be of assistance to you, they are given in accordance with the practice referred to in paragraph 22 of IC 70-6R5 and are not binding on the CRA in respect of any particular situation.

Yours truly,

Jenie Leigh

for Director
Charitable and Financial Institution Sectors
Financial Sector and Exempt Entities Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch